COPYRIGHT ARBITRATION ROYALTY PANEL

\+ + + + +

LIBRARY OF CONGRESS

\+ + + + +

HEARING

IN THE MATTER OF: SATELLITE RATE ADJUSTMENT	DOCKET NO. 96-3 CARP-SRA

Monday,
March 24, 1997

CARP Hearing Room LM414
Library of Congress
101 Independence Ave., S.E.
Washington, D.C. 20540

The above-entitled matter came on for hearing, pursuant to notice, at 10:00 a.m.

BEFORE:

THE HONORABLE LEWIS HALL GRIFFITH, Chairperson

THE HONORABLE JOHN W. COOLEY

THE HONORABLE JEFFREY S. GULIN

APPEARANCES:

On behalf of the Joint Sports Claimants:

The Office of the Commissioner of Baseball:

KATHLEEN A. BEHAN, ESQ.
ROBERT ALAN GARRETT, ESQ.
GARY GREENSTEIN, ESQ.
STEVEN MARKS, ESQ.
Arnold & Porter
555 Twelfth Street, N.W.
Washington, D.C. 20004-1202
202/942-5444

National Hockey League

PHILIP R. HOCHBERG, ESQ.
Verner, Lipfert, Bernhard, McPherson & Hand
901 15th Street, N.W.
Washington, D.C. 20005-2301
202/371-6244

On Behalf of Capital Cities/ABC, Inc.; NBC, Inc.; and CBS, Inc.:

CHARLES D. OSSOLA, ESQ.
Lowe, Price, LeBlanc & Becker
Suite 300
99 Canal Center Plaza
Alexandria, Virginia 22314-5503
703/518-5393

On behalf of Capital Cities/ABC, Inc.:

ROGER GOODSPEED, ESQ.
ABC, Inc.
77 West 66th Street
New York, New York 10023-6298
212/456-7593

APPEARANCES: (CONT.)

On behalf of Broadcasters Claimants Group:

JACQUELINE DAVIS, ESQ.
JESSICA HERRERA, ESQ.
JOHN STEWART, ESQ.
Crowell and Moring
1001 Pennsylvania Ave., N.W.
Washington, D.C. 20004
202/624-2500

On behalf of the Public Television Claimants:

MICHELE J. WOODS, ESQ.
Covington & Burling
1201 Pennsylvania Ave., N.W.
P.O. Box 7566
Washington, D.C 20044-7566
202/662-5347

On behalf of National Broadcasting Company, Inc.:

DIANE ZIPURSKY, ESQ.
NBC, Inc.
1299 Pennsylvania Ave., N.W.
11th Floor
Washington, D.C. 20004
202/637-4535

On behalf of Columbia Broadcasting System, Inc.:

SANFORD I. KRYLE, ESQ.
CBS, Inc.
51 West 52nd Street
New York, New York 10019
212/975-4601

APPEARANCES: (CONT.)

On behalf of The Devotional Claimants:

BARRY GOTTFRIED, ESQ.
Fisher, Wayland, Cooper, Leder & Zaragoza, LLP
2001 Pennsylvania Avenue, N.W.
Suite 400
Washington, D.C. 20006-1851
202/659-3494

and

JOHN H. MIDLEN, JR., ESQ.
Chartered
3238 Prospect Street, N.W.
Washington, D.C. 20007-3214
Washington, D.C. 20007-3214
202/333-1500

and

RICHARD M. CAMPANELLI, ESQ.
Gammon & Grange, P.C.
Seventh Floor
8280 Greensboro Drive
McLean, Virginia
703/761-5000

On behalf of Program Suppliers:

DENNIS LANE, ESQ.
JOHN M. COLLINS, ESQ.
Morrison & Hecker, LLP
Suite 800
1150 18th Street, N.W.
Washington, D.C. 20036-3816
202/785-9100

APPEARANCES: (CONT.)

On behalf of American Society of Composers, Authors and Publishers (ASCAP):

BEVERLY A. WILLETT, ESQ.
ANDREW J. SCHAEFFER, ESQ.
ASCAP
One Lincoln Plaza
New York, New York 10023
212/621-6289
212/621-6275

On behalf of Broadcast Music, Inc. (BMI):

MICHAEL J. REMINGTON, ESQ.
GEORGE GALT, ESQ.
Drinker, Biddle & Reath
901 15th Street, N.W.
Suite 900
Washington, D.C. 20005
202/842-8800

and

JOSEPH J. DiMONA, ESQ.
Broadcast Music, Inc.
320 West 57th Street
New York, New York 10019
212/830-2533

On behalf of Satellite Broadcasting & Communications Association:

PAUL GLIST, ESQ.
JOHN D. SEIVER, ESQ.
Cole, Raywid & Braverman, LLP
1919 Pennsylvania Ave., N.W.
Washington, D.C. 20006
202/659-9750

APPEARANCES: (CONT.)

On behalf of Prime Time 24:

C. TODD HARDY, ESQ.
Hardy & Ellison, P.C.
9306 Old Keene Mill Road
Suite 100
Burke, VA 22015

On behalf of American Sky Broadcasting:

CHRIS MEYER, ESQ.
MIKE KLIPPER, ESQ.
Meyer & Klipper, PLLC
Suite 803
918 16th Street, N.W.
Washington, D.C. 20006
202/496-0830

and

CRAIG HOOVER, ESQ.
JACQUELINE CLEARY, ESQ.
KRISTIN DONOGHUE, ESQ.
Hogan & Hartson
555 13th Street, N.W.
Washington, D.C. 20004
202/637-5600

On behalf of National Rural Telecommunications Cooperative:

JOAN KEISER, ESQ.
NRECA
4301 Wilson Boulevard
Arlington, VA
703/907-5817

APPEARANCES: (CONT.)

On behalf of Library of Congress:

WILLIAM ROBERTS, ESQ.
Senior Attorney
Office of General Counsel
Copyright Office for Compulsory Licenses
101 Independence Ave., S.E.
Washington, D.C. 20540
202/707-8380

ALSO PRESENT:

Tanya Sandros, Administration, CARP
Vivian Roque-Balboa, Administration, CARP
Christine Walsh, Paralegal,
Cole, Raywid & Braverman
Jerry Parker, Witness
Edwin S. Desser, Witness
James Trautman, Witness
Andy Paul, Senior Vice President, SBCA
Kyra Fischbeck, Director of Business
Affairs, Prime Time 24
David Hummel, Witness
Marsha Kessler, Witness
Robert W. Crandall, Witness
Allen R. Cooper, Witness
Bruce M. Owen, Witness

C-O-N-T-E-N-T-S

E-X-H-I-B-I-T-S

P-R-O-C-E-E-D-I-N-G-S

(10:04 a.m.)

CHAIRMAN GRIFFITH: Ladies and gentlemen, good morning and welcome from our abbreviated weekend.

(Laughter.)

MR. OSSOLA: What weekend?

CHAIRMAN GRIFFITH: All right. Let the record reflect, please, that the Court Reporter has been previously sworn and remains under oath.

And I'm going to be presumptuous and presume that this is Mr. Owen.

DR. OWEN: Yes, sir.

CHAIRMAN GRIFFITH: Okay. If you'll raise your right hand, please.

WHEREUPON,

BRUCE M. OWEN

was called as a witness by Counsel for Capital Cities/ABC, Inc.; NBC, Inc.; and CBS, Inc., and, having been first duly sworn, assumed the witness stand, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. OSSOLA:

Q Mr. Owen, please state your full name.

A Bruce M. Owen.

Q Where are you employed?

A Economists Incorporated.

Q And your position there?

A President.

Q Will you briefly describe the nature of Economists Inc.'s business?

A Economists Incorporated is an economic consulting firm that specializes in microeconomic analysis of regulatory problems, antitrust problems, international trade issues, that sort of thing.

Q Has your firm done work in the cable television area?

A Yes.

Q Will you briefly describe your educational background?

A I have a Bachelor's Degree from Williams College and a Ph.D. in Economics from Stanford University.

Q Do you hold any university faculty positions in the field of economics?

A At the moment, I am visiting professor of economics at Stanford University's Washington, D.C. campus. In the past, I have been a full-time faculty member, both at Stanford and at Duke.

Q Have you worked in government as an economist?

A Yes. I worked in government as an economist twice. I was Chief Economist of the White House Office of Telecommunications Policy in the early 1970s, and I was Chief Economist of the Antitrust Division of the U.S. Department of Justice at the end of the Carter administration.

Q And have you published articles and books in the field of economics, telecommunications, and cable television policy?

A Yes, I have.

MR. OSSOLA: I would offer the witness for voir dire, if there is any.

CHAIRMAN GRIFFITH: All right.

MR. GLIST: No questions, Your Honor.

CHAIRMAN GRIFFITH: All right. Thank you.

BY MR. OSSOLA:

Q Dr. Owen, what were you asked to do by the commercial networks in connection with this proceeding?

A I was asked to evaluate the market value of broadcast network signals to satellite carriers.

Q And are the results of your work contained in the written direct testimony submitted under your name?

A Yes.

Q What did you conclude was the fair market value -- was the estimated fair market value of the secondary transmission from the network signals by satellite carriers?

A The best number that -- if one wants to pick one number, the best number is $1.22 per subscriber per month per network.

Q Is that number above the current rate?

A Substantially.

Q Before we get into the details, Dr. Owen, I would like to ask you to summarize for the Panel the principal bases for your conclusion that the fair market value of network signals should be set at

$1.22.

MR. OSSOLA: Before you do that, I would simply say to the Panel that what we would like to do is to do this in a fairly condensed form rather than slog through page by page. And Dr. Owen will proceed to explain both the nature of his analysis and the basis for his conclusion and the methodology that was used.

I would simply invite the Panel, as he does this, if there are any questions along the way, to please interrupt Dr. Owen, because we are going to be covering a fair amount of territory relatively quickly.

CHAIRMAN GRIFFITH: Thank you.

BY MR. OSSOLA:

Q Dr. Owen, why don't we start with Figure 1. And if you could simply explain how you approached your task and the methodology you employed.

A Let me start with the economics as opposed to the statistics. What we want to do is to measure or estimate the value of broadcast networks to satellite carriers in a market setting, a free market setting. And, of course, we don't know what that is, because those transactions don't take place right now.

The closest comparable transactions presumably would be the transactions between satellite carriers and basic cable networks. But we don't have those data. We don't know how much the satellite carriers pay the basic cable networks. We don't know how much DirecTV pays for ESPN, for example.

So we'll take one step further away to use information that we do have available, and we look at what cable operators pay for those same networks. Now, cable operators are like satellite carriers in that they buy these rights, these cable networks, in order to get subscribers, in order to get people who will pay for the right to see the programs on the cable, and to a lesser extent to sell advertising. So the transactions are comparable in that sense at least.

The next question that comes up from an economic point of view is: how do we explain the fact that the fees that are paid for different basic cable networks are not all the same? ESPN costs more for the cable operator than Nickelodeon. Why? Why should that be?

Well, from an economic point of view, the sensible explanation is that ESPN is worth more to a cable operator. And why would it be worth more? It would be worth more if it is more effective, from the cable operator point of view, in getting subscribers to sign up, or getting subscribers to pay more for the monthly fee for the cable system, or to a lesser extent to selling advertising to advertisers.

So the effectiveness of the programming that's on the cable network ought to be an important factor in explaining its value and its price when it's sold to a cable system. And by analogy, the same thing should be true for satellite carriers.

This figure which is in the report shows the actual transactions, or estimates of the actual transactions, for 27 cable networks in 1991, '92, '93, '94, and '95. This is how much each cable network got on average in revenue from cable operators per subscriber per month. And you'll notice that they tend to go up in this direction when measured against how much each of them spends on programming.

Now, why should there be this relationship between fees and programming expense? Well, you might think that the effectiveness of, say, ESPN in attracting subscribers for a cable system or in selling advertising would have something to do with the quality of their programming. When I use the word "quality," I just mean from an economic point of view its effectiveness. I'm not making an aesthetic judgment.

So ESPN has (quote) "better programming," or effective programming, because it buys more expensive programming. And so it's more attractive to cable operators -- cable subscribers; and, therefore, is worth more to cable operators.

Programming is something that the cable networks compete for. This programming is produced by somebody. Much of it is produced in Hollywood. Some of it is produced by sports leagues. They are competing among themselves, and they are also competing with the broadcast networks for this programming.

And the programming which is most effective in generating revenue for a cable operator is going to have its price bid up, just like a star -- a singing star or a rock musician, or any other kind of star, a movie star -- gets paid a lot of money because they're effective in generating revenue for the studios or whoever is producing the programming.

So it's not surprising. It's just common sense that you would expect to find a relationship between how much the programming costs and how much it's worth to cable operators. That's the economics of this relationship, and it really is nothing more than common sense.

Now suppose, given this information about how much cable operators paid on average for each of these networks, one wanted to predict how much any one of them, in fact, would get.

Suppose, for example, that we didn't know what this number was. This is ESPN in 1995. We didn't know what that number -- we wanted to use these other data to predict what that number would be.

Well, there's a way to do that using a

very common ancient statistical technique called regression analysis. All you do is you fit a line to all of those numbers, the best line you can -- I'll get back to that in a minute -- and then extend that line out and use it to predict, given that we know what ESPN's expenditure is, predict what its license fee will be. And that would be the place where -- let me try drawing it this way.

Here is expenditure, and here is fee, and here are all of these dots, and here is the line that we fit to these dots. I'll come back to that. We want to know what ESPN is going to be worth in 1995. We know that ESPN spends $500 million on programming. So we come out here to 500, and we go up to the line over here.

And let's say it predicts 55 cents. That is a commonly accepted way of making predictions of economic variables. It's used in all kinds of different environments. It's used in macroeconomics. It's used in housing markets. Regression analysis has been around for a long time.

Q Dr. Owen, let me ask you at this point if it might be helpful just to give a sort of rule-of-thumb working definition of regression analysis, for purposes of its application here.

A It's a statistical -- regression analysis is a statistical technique for determining the best linear relationship between two variables -- in this case, program expenditure and fees -- given a number of observations on those two variables. These numbers don't all fit on a straight line for lots of reasons -- random noise, measurement error, other variables that are important.

Given all of that, what's the best linear -- the best estimate of a linear relationship between these two variables? Mechanically, what you do is you take a line like this one, you just start with any line, okay, and look at each one of the observations and measure the distance between that line using that observation, that dot, and the line that you are testing. And you do that for each and every observation.

And then, what you do is to change the slope of the line, or the position of the line, in such a way that the sum of the squares of all of these things is at a minimum. Okay? And the result will be a line that goes through these observations, taking advantage of all of the information that's in the observations and provides the best fit, the most accurate fit, for purposes of prediction.

For example, that is what you get if you do the statistical regression analysis on these data. That's the line. And if you use that line to predict ESPN, you'll notice that ESPN is substantially above the line. There are two reasons, or at least two reasons, why it might be substantially above the line. One is that there is some measurement error. Another is that there are other factors.

For example, ESPN is a sports network. Maybe sports networks are inherently more valuable than other kinds of networks.

In order to account for those other variables, we also took into account each category of cable network. In other words, instead of trying to break the cable networks down into sports channels versus non-sports channels, or children's channels versus non-children's channels, or news versus non-news, we gave each individual network its own category.

So every individual network was its own category of programming. And the effect of doing that, in the case of ESPN, for example, is to bring this down very close to the line.

Now, let me make a statement about the general accuracy of this technique. This line, by itself and without any attempts, take into account the categories that I've just been describing, and within each network its own category, just by itself, accounts for more than 80 percent of the variation in these observations.

If we put in the categories -- that is, if we take account of the peculiar characteristics of each individual network, we can account for 99 percent of the variation in these observations. So whatever other information may have been left out, if any, is not enough to make a significant difference in terms of explaining the variation of these data.

Q Dr. Owen, could you explain, at that

point, how did you account for the differences among the cable networks? I mean, you referred, if I may change the question a little bit, you referred to setting up separate categories for the cable networks. Could you explain how that was done and what it reflected, what those different categories actually reflected?

A Well, how it's done mechanically is through the use of what's called a dummy variable. There is a variable that is equal to one if the observation in question is for ESPN, and another variable that is equal to one if the observation in question is for 1995. And there is a different variable, which is equal to one, if it's Nickelodeon, and still another variable that's equal to one if it's Nickelodeon in 19 -- if it's 1992.

So there is a separate category for each of the five years, and there is also a separate category for each individual network, thus taking account of whatever it is, if anything, about the individual networks or years that is peculiar and not explained by this relationship between revenue and --

between program expenditure and license fee.

Q Were there any other variables that you considered factoring into this analysis, other than each different network over a different year?

A Well, we considered lots of possibilities. I think the important point to make is that whatever it is we would add would add very little to the explanatory power of this relationship, since we're explaining 99 percent of the variation in these data as it is.

One obvious candidate thing to add is advertising. Advertising revenue might affect the value of these programs, these cable networks, to cable operators and might affect the fee that the cable network might want to charge, because cable networks that are interested in selling advertising might want to charge a lower fee in order to get more subscribers, and therefore higher audiences, and therefore get more advertising revenue.

And we looked at that, and it turns out that it just doesn't add much to the explanatory power of the relationship, and it doesn't change the $1.22.

If anything, it makes it higher, putting in advertising. But it makes the whole analysis much more complicated.

Q Are you saying that consideration of advertising revenues didn't add anything beyond the 99 percent --

A Nothing significant.

Q -- predictive value?

A Nothing significant.

If there are no questions about this, I'd like to take what's really the final step here. Here is this relationship. It's a very strong relationship statistically. It's a very strong relationship economically. It makes sense economically. What would happen if we tried to use this relationship to explain or to predict what the networks, broadcast networks, would get if they were available on the same basis in a free market to the cable operators.

Well, the dotted rectangle there in the lower left-hand corner is this chart, okay, and what we've done is simply to extend the line out linearly until it goes beyond the point where the average network expenditure of programming is. That's something like $1,800 million per network.

And we plug in that average number, average network is going to do on programming, into this line, draw a dotted line up to the purple dot if you like, and then read off what that is over here, and the answer is it's $1.30. There's an adjustment to be made to get down to $1.22. So we come back to -- that's the prediction.

Now, as I think you can appreciate, this is a long way from here. We don't have a lot of these observations along the way. The observations are all on cable networks that have low program expenditures relative to the networks. And so any slight error in estimating this line, the slope of this line, would have quite a large effect up here. And, of course, you have to allow for the fact that from a statistical point of view there might be such an error.

And so there is a way of measuring, a standard way of measuring, the degree of confidence that one has in a prediction of this sort, given how far away it is from the observations that were used to generate the relationship. And as you might expect, the degree of confidence that one has in a prediction causes this thing to fan out, so that 99 percent probability of getting the right number here becomes a big -- bigger interval when you're this far away.

Let me just state the results in statistical terms. The 95 percent confidence interval for this prediction is plus or minus 55 cents. That means that 95 percent of the time, this $1.30 or $1.22 number will be in an interval between $1.30 plus 55 cents and $1.30 minus 55 cents. Now, of course, the closer it is to $1.30 the more likely it is, if not equally probable, along that whole interval.

Q Is it, Dr. Owen, equally as possible that if there is a variation it could be above the line or below the line? The line being $1.22?

A Yeah. A confidence interval is symmetric. It is as likely that it's 10 cents higher or that it's 10 cents lower. The true value of this purple dot could be, with some probability, 10 cents higher, but with the same probability 10 cents lower.

CHAIRMAN GRIFFITH: We just want this

Panel to -- you are referring to Figure Number 2 in your written testimony --

MR. OSSOLA: Yes.

CHAIRMAN GRIFFITH: -- at this particular time.

THE WITNESS: Yes.

CHAIRMAN GRIFFITH: And the other question I think -- or observation we have at this point is, we want to understand clearly that the projections that you are making at this point is based solely on what the cable operators are paying.

THE WITNESS: Yes, that's correct.

CHAIRMAN GRIFFITH: Okay.

THE WITNESS: Not based on what the satellite operators are paying, because we don't know what they're paying.

BY MR. OSSOLA:

Q On that point, it might be helpful to elaborate a little bit on why this relationship was chosen vis-a-vis the satellite carriers.

A Well, ideally, one would want to look at what the satellite carriers are paying. I think I said that. The most directly comparable transactions are what satellite carriers are paying for these cable networks. And, of course, they know what they're paying, but that information is not available to us. So the cable transactions are simply the best available data from our point of view.

Q Did you consider any alternatives other than the cable operators, what the cable operators pay? Or are there any out there, any other relationships in the marketplace that you considered?

A There are other relationships, but I don't know of any that comes anywhere near the relevance of what cable operators are paying. I mean, obviously, in this proceeding there are other benchmarks that have been proposed. But this is, from my point of view, by far the most sensible economic relationship, economic benchmark, most comparable economic relationship.

I said I was going to come back to the $1.30 versus $1.22. This dot is at $1.30. We adjusted it downward by eight cents to account for the facts, which may not be a fact, that satellite carriers don't or didn't get the opportunity to assert advertising in the cable networks, whereas the cable operators do get that opportunity. And the eight cents comes from the previous proceeding, and it was also used by John Herring in his testimony. So I don't think it's a controversial number.

So the best estimate makes that adjustment, although I understand that there is some indication that the satellite carriers are now inserting advertising, which would make that adjustment unnecessary.

There is another respect in which -- two other respects in which this number is -- prediction is conservative. One is that we're not taking any account in the expenditure measurement of what the stations -- what the affiliated stations whose signals are actually the ones being carried are paying for local programming. This is just the network expenditure.

Q Why didn't you consider that?

A I guess basically because it seemed to be the most conservative approach. Some of that local programming is of local interest, and presumably not of the same interest to distant viewers. On the other hand, much of that programming is of quite general interest. The programming that is on during the prime time access period, or what used to be the prime time access period, is very expensive off network syndicated programming.

The programming that is on in the late afternoon, children's programming, although it's local -- purchased for local broadcast and not from the networks -- is very important from an economic point of view. All of those costs have been included.

The other element here that is important to point out that makes this estimate conservative is this. These are the fees that are earned, on average, by HBO and Showtime -- the so-called premium networks. And these are their program expenditures.

You'll notice that they're way above the line. Including them would have made the purple dot higher, and there are various arguments for including them.

We chose to exclude them for several

reasons, one of which is that the data underlying these dots is not from the same source as the data underlying the process.

Q What is that source?

A This is from -- all from Kagan, the same source everybody else in this proceeding is using basically. These data are not published by Kagan. We had to get them from annual reports and 10(k)s and that sort of information. So they are estimates.

Q Do you have any understanding as to why the program -- why the license fees for Showtime and HBO are so much higher than the basic cable networks?

A Well, obviously, it's that they're spending more on programming. Another reason probably has to do with advertising. They don't have any advertising on those networks. If we had included these premium channels in the regression analysis, it might have been more important than it is to include advertising as a variable.

All of these guys -- all of these -- both the broadcast networks and the basic cable networks have advertising. These people don't. They're different in that respect.

Q So when you say that -- when you're referring to conservative, what do you mean in relation to the $1.22 level?

A I mean that one could reasonably have concluded that the market -- best estimate of the market price of broadcast networks to satellite carriers would be substantially higher than $1.22.

Q Let's go back, if we could, to the 95 percent confidence level. Why did you select that as the confidence level, or use that as the confidence level here?

A Well, I guess there's two reasons. There is no real reason for picking any particular confidence internal, except convention. It is has been conventional for decades to use 95 percent confidence interval as a way of expressing the degree of variation or error, or the range within which the estimate probably will fall.

In the law and economics literature, interestingly enough, the literature associated with Professor Posner -- Judge Posner, and so on, the 95 percent confidence interval is associated with the beyond reasonable doubt standard, as opposed to 50 percent or so for the preponderance of the evidence standard.

So 95 percent has a certain amount of appeal, but there is no magic to it.

Q In terms of -- the application of the 95 percent confidence level yields that 55 percent variable, or variation in the $1.22 up or down, is that right?

A 55 cents, yes.

Q 55 cents. Would you explain a little further what the probabilities are that the number actually would be $1.22 as opposed to 55 cents higher or lower?

A Well, relatively speaking, it is more likely to be $1.22 than 55 cents lower. But here is the way this looks. You think about the range that I'm talking about, the range of error, the 95 percent confidence interval around this dot. Think about the usual bell-shaped curve that you see for statistical distributions.

Think of it sticking out above the surface of this board, and it would look something like this. This is $1.22, or $1.30 before the eight-cent adjustment.

MR. GLIST: Dr. Owen, would you allow me to see what you are drawing? Perhaps it --

THE WITNESS: I don't have a lot of choices of where to stand here.

MR. OSSOLA: It's more important to face it.

(Laughter.)

THE WITNESS: This is $1.22 plus 55 cents, which is, what, $1.77? And this is minus 55 cents. And the area down here and the area over here add up to five percent. There is a five percent probability that the true value is either above or below the 55 percent confidence interval.

The probability that it is 55 cents is that compared to that. It's much higher in the middle. It's much more likely to be around the mean than it is to be quite distant from the mean.

BY MR. OSSOLA:

Q Is that likelihood a product of the curve?

A Well, the nature of the statistical distribution, it's a normal distribution, and the nature of a normal distribution is that the values near the mean are more frequent, more likely, than the values that are far away from the mean.

Q Dr. Owen, why would satellite carriers set fees at less than fair market value?

A Set what fees?

Q Well, let me ask it a different way. What is your understanding of the relationship between the current network rate and fair market value?

A The current rate that is set by this arbitration process, or the Copyright Royalty Tribunal, is much less than the market rate.

JUDGE GULIN: I think you mean retail rate. Is that what you mean to ask, what the retail rate is?

MR. OSSOLA: Well, yes. I was going to get there. Sure.

THE WITNESS: Is that the question?

MR. OSSOLA: Yeah. I actually was going

to lead you to the retail rate.

THE WITNESS: The satellite carriers now charge a little bit -- well, around this number, maybe a little bit less, per broadcast network to subscribers.

BY MR. OSSOLA:

Q When you say "this number," what are you referring to? $1.22?

A $1.22.

CHAIRMAN GRIFFITH: The satellite carriers?

THE WITNESS: Satellite carriers, when charging subscribers -- consumers -- now charge this number or less, somewhat less. So how do you explain that? How can it possibly be that the wholesale value of these signals is $1.22 when the retail value that is measured by what they are charging is less than that?

BY MR. OSSOLA:

Q Now, when you say "charging," you're talking about what they're charging, what the satellite carriers are charging their customers?

A Yes. The satellite carriers are charging their customers a number which is less than $1.22, or thereabouts.

Well, what determines what the price to the subscribers is? What determines what the price to subscribers is? Well, there are two candidate explanations that are pretty obvious. One is: how much does it cost them to buy those signals? The answer is: six cents. Right? So when they sell it for $1 or $1.22, they're making a huge profit, even though that number is less than the true market wholesale price.

The only reason why that price might be lower than otherwise is because these are very important popular signals. The broadcast networks -- ABC, NBC, CBS -- are extremely high quality in my economic sense, very popular broadcasts, and people really want to have them.

And so it's useful, from the point of view of the satellite carriers, not to price those signals excessively high in order to attract subscribers, and then be able to charge them for all of the other services that are on the satellite, all of the other cable networks that are on the satellite.

So there's both sort of a lost leader marketing reason for wanting to not price satellite -- not pricing broadcast signals very high. And there's just a plain old economic cost reason. It's very cheap for them to buy these basic --

Q What consideration did you give to the impact of the $1.22 rate on the satellite carriers themselves?

A Well, we tried to assess the extent to which that $1.22 payment, if actually imposed by this Panel, would have an adverse impact on the -- or a significant adverse impact on the satellite carriers, and my conclusion was that it would not. There were several possible assumptions one could make in the course of coming to that conclusion.

One assumption is that the carriers might pass it all on to subscribers. They may simply raise their rates for broadcast signals by $1.22, from whatever it is now to $2-and-something per channel per network. I don't know that they would do that. It's just if they did that, obviously there would be no impact on networks -- de minimum impact -- unless they were to lose a lot of subscribers as a result. And they're not likely to lose a lot of subscribers because of the importance of these signals to subscribers.

After all, we're talking about subscribers who laid out $3,000 and up for c-band dishes, to the extent we're talking about c-band satellites here. These are people who really need a television. They're paying a lot for it.

Q Are they also -- are you talking about any other characteristics of these particular subscribers, in terms of the people who would value the network signal at a high level?

A The people who are paying for the upfront costs of a c-band satellite dish and the associated electronics, or a Ku-band equipment which nowadays costs something like $800, including subscription fees, simply place a high value on television. We know all viewers, on average, place a high value on network signals.

There is economic evidence of that from all sorts of places, not least what they're willing to pay for television sets. People really value television. They place a high value on it, and they place the highest value on network broadcasts.

The other range -- the other end of the range of assumptions you can make about the impact on satellite carriers is to assume they don't pass any of it off. So if you increase the fee to $1.22, and they don't pass any of that on to subscribers, they have to eat it all, what does that mean?

Well, it comes out to about $56 million a year, which is quite a small number compared to their revenue, quite a small number compared to the investments that the satellite carriers are now making. You know, we just learned a week or two ago about Mr. Murdoch's plan to build Sky a new Ku-band direct satellite system, which would have eight satellites and spot beams and carry local signals in each local area around each city.

And the investment cost of that is upwards of $3 billion. What MCI paid for the slot formerly occupied by Tempo was close to $700 million. These people obviously expect to earn a lot of profits in the future, and that explains their willingness to make these investments. And the numbers involved are far greater than $56 million a year, in terms of the payment for market value broadcast network signals.

Q Did you also consider the impact of the $1.22 increase on viewers?

A Well, as I said before, I think that it's kind of unlikely that the satellite carriers would increase rates by $1.22, because of the importance of these signals as tools in selling the cable -- in selling the satellite service. Remember, we're talking about white areas. Unlike cable territories, there is no over-the-air signal available. So getting the broadcast signals in broadcast networks on the satellite is the only way to get them.

Q Did you also consider the effect of the $1.22 increase on the networks themselves?

A Yes. The networks themselves would get more revenue, obviously. The networks, however, are, as I pointed out before, in competition with each other for advertising revenue, and for that matter in competition with all of the cable networks for advertising revenue. And they are also in competition with each other for programming, and in competition with these people for programming.

And to the extent that it becomes more profitable to get satellite subscribers, because of the increased fee that they would get -- $1.22 versus six cents -- there would be a tendency to compete away that increased revenue in the form of higher program expenses, to the extent the price -- spending a little more on programming, you can get more satellite subscribers. Then that would be a sensible, profitable thing to do. And in competition, they would be rival. They would be competing against each other to get those subscribers.

So some at least, perhaps all, of the increased revenue may be competed away in the form of higher quality, in my sense, programming.

Q Did you consider the impact on copyright owners, other than the networks? That is, copyright owners who may have an interest in the network signal, other than the networks themselves.

A Yeah. The form of the -- if the networks compete away the $1.22, or some of it, in higher payments for programming, where does that money go? It goes to Hollywood or to sports leagues or wherever the programming is coming from. The effect of it is for that money to flow through to the ultimate copyright owner.

Q Let me go back, if I may, to the effect of the $1.22 rate on satellite carriers. Do you know what the estimated revenues, at least at the time you prepared this report, for the satellite carrier industry was for 1996?

A My recollection is it is about a billion dollars.

Q Did you make any assessment in your report of the projected growth in those revenues?

A Well, I didn't make an assessment of it, but I did look at what Wall Street pundits were forecasting, and they all forecast substantial growth in that revenue for the region. As I explained a few minutes ago, the new services that are coming along --

DirecTV and Sky, and so on. And I think three or four years later they are forecasting revenues of upwards of $5 billion.

Q Did you also consider the expected growth in DBS subscribers themselves, not just the revenues, but --

A Well, that's the basis of the revenue forecast.

Q That revenue forecast, then, the DBS subscriber growth, is set forth in page 30, Figure 3, of your testimony?

A Yeah. This Figure 3 on page 30 is, you know, the actual transcription of what is available from the Wall Street analysts. It shows the high and the low estimate made by these analysts of people -- of direct broadcast satellite subscribers over the next, what, 15 years or so, and the average. So by 1998, on average, they're showing somewhere between five and 10 million subscribers.

Q The $56 million increase that you mentioned earlier, for what years would that increase be anticipated?

A Half of that this year. We're starting in June. And then $56 million a year for each of the next two years I guess.

Q So it would be half of that for 1997, and for the following two years, $56 million each?

A Right. Assuming it was not escalated.

MR. OSSOLA: May I have one moment?

CHAIRMAN GRIFFITH: Very well.

MR. OSSOLA: Would the Panel indulge me in a very short break?

CHAIRMAN GRIFFITH: Okay. How long?

MR. OSSOLA: Just to determine whether we have anything else on direct.

CHAIRMAN GRIFFITH: How long do you want?

MR. OSSOLA: Five minutes.

CHAIRMAN GRIFFITH: Okay. A five-minute recess.

MR. OSSOLA: Thank you.

(Whereupon, the proceedings in the foregoing matter went off the record at 10:48 a.m. and went back on the record at 10:58 a.m.)

MR. OSSOLA: I have nothing further on direct.

CHAIRMAN GRIFFITH: All right. Cross examine?

CROSS EXAMINATION

BY MR. GLIST:

Q Dr. Owen, for the record, I am Paul Glist. I represent the Satellite Carriers in this case.

Back before there was cable television or satellites, the commercial networks spent money on programming, didn't they?

A Yes.

Q And they did that to deliver audiences, didn't they?

A They did that in order to generate audiences to sell to advertisers, yes.

Q Right. It wasn't to sell programming to viewers directly, was it?

A That's correct.

Q And you're familiar with cable copyright, are you?

A You've got to be more specific than that.

Q Are you familiar with the cable television compulsory license embodied in Section 111 of the Copyright Act?

A Generally, yes.

Q That was adopted in 1976, is that right?

A Originally, yes.

Q Originally. And so 1976 was the first time that broadcasters could collect royalties for cable carriage or broadcast signals?

A You're really asking me a legal question. I guess that's my understanding, but, you know, you have to go back to the Supreme Court decisions in the '60s on Fortnightly, and so on. I'm not intimately familiar with all of that law.

Q But your understanding is that Fortnightly said one could not charge a royalty, and then the '76 Act said one could?

A Among other things, yes.

Q Now, under that scheme that was adopted by Congress in 1976, weren't the commercial networks precluded from getting paid for national network programming already on the network broadcasts?

A Precluded by what law?

Q By the compulsory license.

MR. OSSOLA: I'll object. I think that does call for a legal conclusion.

CHAIRMAN GRIFFITH: Mr. Glist, do you have any response?

MR. GLIST: He's being offered as an expert in this area. If he can answer it within the extent of his knowledge, I would appreciate that. If I'm out of the boundaries of his knowledge, then we can --

MR. OSSOLA: We are not presenting the witness as an expert under Section 111.

CHAIRMAN GRIFFITH: I understand.

MR. OSSOLA: So I think it goes beyond the scope of direct.

CHAIRMAN GRIFFITH: The objection is sustained.

BY MR. GLIST:

Q Do you know whether cable television operators pay royalties to the commercial broadcast networks?

A The payment --

MS. WOODS: Objection. Perhaps I didn't hear the question correctly. Did he say to the broadcast networks, or for the broadcast networks?

MR. GLIST: I believe I said to.

CHAIRMAN GRIFFITH: To.

MS. WOODS: Directly to? Well, I guess on that ground I would object to that question, if this is the still related to Section 111, first of all, because the witness isn't discussing that. And secondly, because Section 111 doesn't provide for the payment of royalties directly to broadcast networks or anyone else.

CHAIRMAN GRIFFITH: Mr. Glist, do you have any response you want to make to that?

MR. GLIST: I'm happy to amend it to say for, if that clarifies where we're going.

CHAIRMAN GRIFFITH: Why don't you do that.

BY MR. GLIST:

Q Dr. Owen, do you know whether cable television operators paid royalties for the carriage of commercial network stations?

A My understanding of the situation is that cable operators pay fees set by -- originally by the Copyright Royalty Tribunal or by statute for various kinds of network signals, all of which are very small and set not by market forces but by government agencies. And as an economist, I don't have much interest in that, so I haven't paid attention to the details.

Q Is it fair to say that the commercial broadcast networks are almost entirely advertiser supported?

A It's probably a fair generalization. They have other sources of revenue, besides advertising. But I'm sure that advertising is the predominant revenue source.

Q I mean they spend, according to your calculations, $1,800 million a year in programming, and they're presumably getting compensated for that in some way?

A Indeed.

Q And they're getting compensated by the sale of advertising?

A Yes.

Q And that's what ratings are for, isn't it, to help advertisers make their purchase decisions?

A Ratings are measurements of the size of the audience. The advertisers care how big the audience is that sees their ads, and the rating services provide what is supposed to be a third party objective measurement of that.

Q And the commercial network broadcasts -- excuse me. The commercial networks actually pay their broadcast affiliates to distribute network programming, don't they?

A Well, no, I don't think that's an accurate way to describe what happens. The relationship between broadcast networks and broadcast affiliates has got several dimensions, the two most important ones of which are that the network sells advertising time on the station on behalf of the station, and the network acquires programming on behalf of the station.

So the station is the one that has the time, the actual advertising time and the audiences that are being sold, and the station is the one that has the programming. The network is, in effect, the agent for the station in both respects.

And the flow of money, with respect to both of those agencies, is in opposite directions. To the extent that the network is selling advertising time on behalf of the station, you'd expect the network to be remitting money to the station. But to the extent that the network is acquiring programming on behalf of the station, you'd expect the station to be paying the network.

There is no particular reason why the net of those two numbers should come out plus, minus, or zero. It happens historically that it has come out in such a way that there is a net flow of money from networks to stations, which they call network compensation. But there is no particular economic significance to that, because of these two different functions that are going on.

Q But if we were to just isolate that aspect of the relationship between a commercial network and a broadcast affiliate, one would see that the general rule is that there is money flowing from the commercial network to the broadcast affiliate, is that correct?

A As I just explained, yes.

Q And that's the relationship that has developed in the free market today between commercial networks and their terrestrial affiliates?

A Yes.

Q And we can measure that flow directly, can't we?

A I'm not sure what you mean.

Q Well, for example, if you were to look up in Kagan for network compensation payments by commercial networks to their affiliates, there is a number there, right?

A I haven't actually done that. I'll take your word for it.

Q You haven't looked at --

A I haven't had occasion to do that. I don't know that Kagan publishes those data. I'm not denying the existence of it. I'm just saying I don't know.

Q So you did not investigate that when you attempted to study this particular market relationship that we're inquiring into?

A I can't imagine why it would be relevant, no.

Q Basic cable networks also sell advertising, as you testified on direct, is that right?

A They sell national advertising and some of them also provide availabilities for local cable operators to insert local commercials.

Q And basic cable networks reach a substantially smaller audience than the commercial broadcast networks reach, don't they?

A Yes.

Q And that's because the broadcast networks are available to over 90 million television households?

A No, it's because the broadcast networks produce much superior programming, which attracts more viewers.

Q I'm talking about --

A Broadcast networks get much higher ratings than cable networks, even on cable systems.

Q Well, let me come at this in a slightly different way. Are you saying that cable networks can reach customers who are neither cable subscribers nor satellite subscribers?

A No.

Q But the broadcast networks can reach an over-the-air audience that is off of cable and off of satellite, is that right?

A Yes.

Q And basic cable networks can only reach those customers who are subscribing to packages that include those basic cable networks?

A Right.

Q Have any of the basic cable networks achieved the advertising revenues that the commercial broadcast networks have achieved?

A No, I wouldn't expect that they could until they start spending as much as the broadcast networks do on programming.

Q And the broadcast networks are earning, what, about $9 billion a year in advertising revenue?

A I haven't looked that number up recently either, but I won't argue with it.

Q That sounds about right to you?

A It could be right.

Q Is there another number that would sound righter to you?

MR. OSSOLA: I object. I think the witness has said he doesn't know what the number is.

CHAIRMAN GRIFFITH: He hasn't looked up the number. The objection is sustained.

BY MR. GLIST:

Q Now, the commercial networks -- cable television networks, they rely both on a subscriber revenue stream and an advertising revenue stream, is that generally the relation?

A Yes.

Q And a multichannel video program distributor, he packages these together in order to obtain subscriptions from customers?

A Yes, she does.

Q Now, the broadcasters want to be in that package, don't they?

A Which broadcasters?

Q Television broadcasters.

A Well, their desire to be in that package surely has something to do with what the price is, at what price do they desire to be in that package.

Q Well, didn't the broadcasters go to Congress and get a must carry law?

A I thought they got a retransmission consent.

Q But didn't they also get a must carry law?

MR. OSSOLA: I object. This is beyond the scope of direct.

MR. GLIST: I'm inquiring into the relationships between the broadcasters and multichannel video program distributors. I think this is highly relevant to the conclusions that he has drawn.

CHAIRMAN GRIFFITH: Okay. The objection is overruled.

BY MR. GLIST:

Q The question is whether you know whether broadcasters obtained a must carry law from Congress.

A I know that there is a must carry law. As to the politics of how it was obtained, I'm not familiar with that.

Q Do you know whether the cable industry was asking for must carry?

A I doubt it.

Q And, in fact, don't you know that the cable industry has been opposing must carry?

A In its current form, yes.

Q Now, you also mentioned just a moment ago that the broadcasters obtained retransmission consent rights in federal law, is that correct?

A That's my understanding.

Q And on page 2 of your testimony, you say that broadcast networks and their affiliates do not voluntarily sell their signals on a per subscriber basis. But didn't they try to in 1993?

A I don't know.

Q Do you know whether the commercial broadcasters attempted to extract payments for the grant of retransmission consent from the cable industry?

A I am aware that there were negotiations between broadcast networks on behalf of their affiliates and various individual cable systems or MSOs with respect to these statutorily set rights, yes.

Q Okay. And those negotiations revolved around whether or not the networks would grant retransmission consent to cable television MSOs?

A Well, I thought it was whether the stations would. But I wasn't involved in the negotiations. I don't know the details of it.

Q Do you know whether any of the commercial networks obtained license fees of $1.22 from cable operators?

A I'd be surprised if they did.

Q Do you know what they did obtain from cable operators?

A Not in any detail, no.

Q Have you heard of the launch of ESPN-2 or America's Talking?

A Yes.

Q Those were launched in and around those retrans. negotiations in 1993?

A My understanding from reading the trade press is that some of the networks got cable systems to agree to make available channel capacity, channel space, for new cable networks that were to be owned by the broadcast networks, ESPN-2 being an example.

Q And America's Talking being another?

A I don't know about that one.

Q You don't know. Okay. Well, then, for ESPN-2, that was and is owned by ABC?

A That's my understanding.

Q When ESPN-2 was created, did the ABC television network simply take their commercial broadcast feed and put it into ESPN-2?

MR. OSSOLA: I think that goes well beyond the scope of direct. I'll object to that.

MR. GLIST: These are basic cable networks, which are the essence of his study of the relationships between commercial network broadcasters and multichannel video program distributors. I think I have a right to determine what actually took place in the marketplace in launching such channels and such relationships.

MR. OSSOLA: Counsel is talking about an FCC scheme, retransmission consent, which was not addressed by the witness and is not dealt with in his report in any detail.

MR. GLIST: He volunteered retransmission consent in an answer to me when I inquired about must carry.

MR. OSSOLA: Well, I objected to that question as well.

CHAIRMAN GRIFFITH: Okay. The objection is overruled.

BY MR. GLIST:

Q Do you remember the question, Dr. Owen?

A No.

Q Do you know whether in creating ESPN-2 the ABC television network simply took their commercial broadcast feed and placed it into ESPN-2?

A The ABC feed, as opposed to the ESPN feed?

Q Yes.

A Yes, I do know.

Q And what is the answer?

A No.

Q They did not. They acquired other programming and placed it in ESPN-2?

A I believe so.

Q And they formed a cable network, ESPN-2, which was based on the dual revenue stream that we have just talked about for basic cable, isn't that correct?

A Yes.

Q That was a free market result in 1993, wasn't it?

A No. It has nothing to do with the free market. It was a relationship set up by a very artificial statutory scheme, and it has nothing to do with the free market. I'm sorry.

Q You're saying that because the broadcast stations had the right to say "do not carry me," and their bargaining over that right does not reflect a market transaction?

A I think the whole relationship between cable systems and broadcast stations, copyright relationship, is set up by an artificial statutory scheme, you know, which there are compulsory licenses and license fees set by other than market processes, and it just is not a free market environment.

Q And, therefore, you are ignoring those relationships that arose around retransmission consent?

A Well, not entirely. It occurred to us that it was possible that there might be some special relationship between expenditures and the -- let me find the right -- between expenditures and fees for those particular cable networks that were the subject of those retransmission negotiations.

And so we tried to determine which network -- which cable networks were owned by broadcast networks, ESPN being the most prominent example, and looked at the relationship between their fees and their program expenditures in the relevant years, which I guess are '93, '94, and '95, and just putting a separate variable in the regression for that possibility, to see whether there was some special effect of the retransmission consent on the relationship between expenditures and fees.

And what we discovered was that the relationship did change, but very slightly and in the direction of making the $1.22 number higher, not lower.

Q But in the course of the development of ESPN-2, we had an opportunity for ABC to place its network broadcasts on a cable network that was guaranteed carriage and they did not do so.

A I don't understand why you would suggest such a thing. The ABC network acquires programming from various copyright sources, various program sources -- sports leagues, Hollywood, whatever -- and they acquire the right to free over-the-air network broadcasts. They don't acquire the right to put it on pay cable, put it on satellite, or anything else. That's why there's a compulsory license, or that is supposedly why there is a compulsory license.

Q So they had not renegotiated their programming agreements in order to be able to clear the satellite rights. Is that the idea?

A The broadcast networks have not started selling their programming on cable or on any other pay medium. I guess they couldn't, given their current rights situation. Clearly, they could do so in a free market environment. That is, they could acquire the right to do that if they were willing to pay more than whoever else was bidding for that right.

And their failure to do so it seems to me has chiefly to do with the state of the political constraints that the broadcast networks face. Were they to try and charge for their programming, there would be I think a reaction politically.

Q A political reaction. The commercial broadcasters have to operate in a real political environment, is that right?

A We all do.

Q And that affects some of the commercial arrangements that they undertake?

A Well, the possibility that the government might intervene may constrain their ability to do whatever would be the most profitable course of action.

Q Now, is it fair to say that network broadcasting is not really in the business of selling programming to audiences?

A The broadcast networks?

Q Yes.

A Are not in the business of selling programming to audiences under the current set of arrangements. That's right.

Q And, in fact, haven't you written something to the effect that it's a most serious mistake for an analyst to assume that advertising supported television broadcasters are in the business to broadcast programs as opposed to collect audiences?

A Yes.

Q You recently wrote this video economics text?

A Yes.

Q And in that text, didn't you also offer a vision of the future for the networks, or a possible future, to suggest that maybe they could have a dual broadcast -- one for free over the air and another for pay without commercials?

A That must have been my co-author.

(Laughter.)

I remember something like that, but you'll have to show me the actual --

Q Okay. Let's do that, then.

(Laughter.)

I'm going to walk around with the title page and --

A You really should have brought copies of the book.

Q I have the whole book here, if you need it.

MR. GLIST: Are we on 30?

(Whereupon, the above-referred to document was marked as SBCA Exhibit No. 30-X for identification.)

BY MR. GLIST:

Q I believe that the quotation is at the bottom of the page, Dr. Owen.

A Which particular sentence are you --

Q It says, "Broadcast networks produce audiences to sell to advertisers. They might charge viewers, in addition to or instead of advertisers, just as cable networks do. This might involve conversion of over-the-air broadcasts to paid broadcasts using scramblers already developed for cable, or perhaps dual broadcast programs by cable without ads for pay, and over-the-air with ads and without viewer charge, for example."

That was what I was referring to as one vision of the future for the commercial networks. Are those not your words, or words in the book that you co-authored?

A Well, I think you read what was on the page accurately. This is a section of a chapter on network economics in which there is a fairly long series of alternative future strategic possibilities for the broadcast networks that are described and analyzed. And this is one part of one.

Q Are there other strategic options that are not summarized there?

A In the chapter?

Q Yes.

A Yes.

Q And what are those?

A I'd have to look at them. I haven't looked at this since 1993.

Q I see. Well, let's just take this particular vision for a moment. Suppose that there is an alternative of for pay without commercials, and with commercials for free. Now, as I understand the essence of your testimony, we had come to the networks $9 billion in advertising revenue.

A Yes.

Q And then, to that, you would add -- what was your estimate, $50 million a year?

A $56- per year, annual rate, yes.

Q $56 million a year. And that's assuming one million subs for nets. Is that right?

A One million white area subs.

Q One million white area subs for nets leads to that figure. So your proposal is to add this to this existing revenue stream for the networks?

MR. OSSOLA: I'll object to counsel's characterization of this as a proposal. He stated that the $1.22 would derive that number.

MR. GLIST: I believe that his testimony

has been offered in support of a charge of $1.22, which he would add to the existing revenue stream.

MR. OSSOLA: Well, it's also false because there is no evidence, in fact, as to the contrary that the commercial networks get all of that money. I mean, I think the witness testified that some of the $56 million is going to go to the program suppliers, the copyright owners. And counsel is suggesting here that the networks have $9 billion in revenues and $56 million would be added to it, and it would all be network money.

CHAIRMAN GRIFFITH: The objection is overruled. He can answer and explain that if he'd like.

Yes? Excuse me.

MS. WOODS: Michele Woods. Your Honor, may I just inquire if this is an exhibit?

CHAIRMAN GRIFFITH: 30X.

MR. GLIST: It's 30X.

MS. WOODS: Thank you.

BY MR. GLIST:

Q Is the essence of your testimony to add this subscriber revenue stream to the existing revenue streams enjoyed by the networks from advertiser support?

A I wouldn't say that. I think the essence of my testimony is that there is a very strong relationship between program expenditure and the market value of cable networks to cable systems, and that the best way to predict the market value of broadcast networks to satellite carriers is to base that prediction on the relationship between program expenditures and fees paid by basic cable networks.

Q Okay. But in setting the $1.22, you're not proposing to remove the ads that are contained within the network fee, are you?

A Of course not. No more than I'm taking the ads out of the basic networks. All of these blue guys have advertising revenue.

Q Okay. You're not going to take the ads out. You're not going to cut them from 10 minutes to five? That's not a proposal?

A I'm not going to do anything to them.

Q And you're not proposing that advertising revenues be shared between the broadcast network and the satellite carrier? It's not a part of your $1.22, is it?

A No. But I'm not trying to paint a picture of the entire future relationship in the industry. I'm just trying to come up with what the market value would be if broadcast networks were free to charge -- to compete with each other, to charge broadcast -- to charge satellites for their signals. And, you know, what happens as a result of that in terms of the structure of the industry is what happens. I haven't looked at that.

Q Okay. When you go into this analysis -- well, we're right here, aren't we? What you're doing is starting from these basic cable networks that have a certain amount of advertising revenue and a certain amount of license fee revenue, and developing a relationship between that license fee and program expense in the basic cable business. Is that right? That's where we start?

A Well, your question wandered to advertising revenue, so I'm not quite sure I understand it.

Q Well, the basic cable nets I thought we had determined themselves looked to sources of revenue advertising and license fees?

A Yes.

Q Okay. Well, if that's the universe, you're starting with those basic cable nets, and these are the ones which reach fewer audiences than the television broadcasters, right? That's the universe we're starting with?

A They weren't selected on the basis of the fact that they reach fewer people. They were selected on the basis of what was available in terms of data.

Q Do these basic cable nets reach the same size audience as the broadcast networks?

A No, they reach a much smaller audience.

Q Much smaller audience.

A Because their programming is less attractive.

Q And I believe you have defined attractiveness as costing less money, in your testimony?

A Well, no. It's in terms of the effectiveness of the signal in attracting revenue for cable operators, and, by analogy, satellite operators.

Q Oh. It was quality that you referred to as the cost of production and popularity, is that right?

A The best measure of quality that is available to me as an economist is how much gets spent on the programming.

Q Okay. Now, these basic cable networks that don't reach the same audience, and they rely on license fees to supplement their revenue so they can stay in operation, that's how they work?

A I'm not sure I would characterize it that way. There are various networks in there. Some are heavily dependent on advertising revenue, and some are heavily dependent on subscriber -- or from cable operator license fee revenue. There's a whole range.

Q There's a range in there. But out here, these commercial broadcast networks, they are sustained almost 100 percent on advertising, is that right?

A Yes, that's correct.

Q And these, HBO and Showtime, these are sustained entirely on license fees and not advertising?

A That's right.

Q And these are -- there's a different economics in this one, isn't there? The customers pay a premium to not receive ads with these movies?

A Other things equal, I suppose that people are willing to pay more for programs without ads, yes. Not everything else is equal, so you have to worry about that a little bit.

Q In life, there are a few things like that, right?

A We do our best with the regression analysis to take that into account.

Q Well, let's look at a sentence that has been troubling me on page 11 of your testimony. You say, "The fees reflect the value to the cable network of having its advertisements distributed by cable systems because basic cable networks are partly advertiser supported. Therefore, the free market broadcast network license fees calculated here already account for any value to the networks of the satellite carriers distribution of network advertising."

Now, all of the -- the broadcast networks are not partly advertiser supported, are they? They are almost entirely advertiser supported?

A In today's world, yes. But we're talking about a world where they would be partly advertiser supported. We're trying to predict what they would be worth in an environment where there is both advertiser support and subscriber support. That's the whole point of saying that these guys are relevant to this prediction. These guys are not just advertiser supported.

Q Well, if we look at what happens today, though, if the relationship that has been worked out in the marketplace between broadcast networks and their terrestrial broadcast affiliates is one of network compensation being paid to the affiliates, doesn't that reflect the value to the networks of having their programming distributed when it's 100 percent advertiser supported?

A Not on a subscriber supported medium. The viewers who view the affiliates are not paying. As you've just pointed out, this is 100 percent advertiser supported in today's world. But what we're trying to find out is what these networks would be worth in a world that is not entirely advertiser supported -- in other words, in a world like this world.

Q But in today's world, to a terrestrial broadcast affiliate, these are worth a negative license fee?

A I think I've already explained that that is a complete misreading of the economic situation.

Q Because you want to look at the entirety of the relationship between the broadcast affiliate and the commercial network?

A The implicit value of the programming that the affiliate is (quote) "buying" from the network is truly positive. And the fact that there's a net flow of money in the other direction has to do with the fact that the network is also acting as an advertising agent, or an agent in the sale of advertising.

Q Which is its primary business? Selling ads?

A And acquiring programming, yes.

Q In order to attract audiences to see those ads?

A Exactly.

Q Okay. I want to ask you to walk with me through a fairly simple assumption that has to do with me as a subscriber to cable service. Assume that I live in Alexandria, Virginia, as I do, and I can watch all of the network stations off the air in Alexandria. But I pay for basic cable off of Jones Intercable. That's fairly typical today, isn't it?

A So far.

Q So far. I mean, most TV households are cable subscribers?

A About 60 percent.

Q That's most.

A That's 60 percent, yeah.

Q Okay.

(Laughter.)

No plus or minus here.

And I also subscribe to something that I know as expanded basic, a package of basic cable nets above basic broadcast service. Is that also typical for a cable subscriber today?

A Many cable subscribers do, in fact, subscribe to expanded basic, yes.

Q Would that be the majority of basic cable subscribers?

A Well, the last time I looked at this number, which was several years ago, it was over 90 percent.

Q Now, I'm not taking -- well, let me just ask you. If I can get the broadcast networks over the air, what am I paying for to receive broadcast basic on cable?

A The improved reception.

Q Improved reception. And would I be paying for the availability of basic cable networks from this same --

A I'm sorry. I've lost track of the -- you're talking about what you're paying when you -- what you're paying for when you pay your monthly bill?

Q Yes.

A As opposed to components of it?

Q Okay. Well, for broadcast basic, it's for the clarity of reception, right?

A Well, basic cable includes more things than just over-the-air stations. I'm just not following where you're going.

Q Well, my particular cable operator has a broadcast basic tier which contains all of the broadcast stations.

A And other things.

Q C-SPAN. Then, there is a package above that called expanded basic --

A Yes.

Q -- in which all of these are located. Okay. Now, with respect to taking the expanded basic, I'm paying for the availability of cable networks? That's what I'm paying for?

A You're paying for a bundle of services, and an important component of that bundle are the cable networks that are included, yeah.

Q Okay. Well, let's go to satellite homes.

Suppose that I am a viewer who lives right on the edge of a white area, okay? And I go to buy a dish, and the salesman coaches me to say I can't get broadcast networks over the air. And I subscribe -- I want to subscribe to the full package, which includes broadcast networks.

Now, I can actually get these over the air, but I want to buy them off the dish. What am I paying for there, if I can get it off the air? Clarity of reception?

A Well, I guess there are several things. You're paying for clarity of reception, at least if it's a Ku-band satellite. You're paying for the convenience of not having to fool around with an AB switch, and you may be paying for the non-network content of the particular signals that are on satellite.

Q And might I also be paying for -- well, I mean, those are things that I might be paying for. And those are -- that's a value that a satellite carrier would deliver to me as a customer, right?

A As a non-white area customer, yes. I

thought we were talking about white area customers here.

Q I'm talking about someone who is right on the edge.

A Well, they're either a white area customer or they aren't.

Q Is the satellite carrier also putting all of these various services that are available into a package of programs for his customer?

A Well, not a package. My familiarity with -- I subscribe to one of the satellite services, and my understanding of that service is that there are a number of different packages you can subscribe to with various components. It's not just one package.

Q Did you get an electronic program guide with that service?

A Yes.

Q And does that include listings for the broadcast networks?

A Yes.

Q Okay. Let's go back to the customer who is not a subscriber of any MVPD.

A White area customer or not?

Q He is my next door neighbor in Alexandria. He is a never. He hasn't been signed up yet.

On page 6 of your testimony, you say broadcast networks do not receive subscriber revenue directly or indirectly for their signals. And on the other side of that transaction on page 16, you say that viewers do not pay.

A Where are you?

Q I thought I was on 16, but --

A You mean on the top of 16? "There is good evidence that consumers are willing to pay substantial sums for the quality programs broadcast by the major networks."

Q Even though they're not called upon to --

A Even though they're not called upon to make such payments.

Q Okay. So the way it's analyzed in your testimony, it's that there's no payment flowing from the viewer to the commercial network, is that --

A Which kind of viewer are we talking about?

Q Over --

A Your neighbor in --

Q My neighbor not connected to cable --

A There's no direct other than through advertising.

Q Other than through advertising. But, okay, could an economist look at that same transaction as the viewer making payment by watching commercials?

A An economist might associate the time spent by viewers -- actually, not only commercials, but the programs themselves as a kind of payment to the extent that it has an opportunity cost. Opportunity cost means you could be doing something else that's worth more to you like working.

Q Okay.

A I think it's for that reason that broadcasters try as hard as they can to make the commercials entertaining so there isn't any opportunity cost.

Q But is it fair to say that there is an abundant amount of evidence that viewers generally prefer programs without commercials?

A I'm willing to make that assumption, but

I don't know what the evidence is.

Q You don't know what the evidence is?

A No.

Q Well, I thought you wrote about this.

I'm going to distribute a page from your book.

CHAIRMAN GRIFFITH: Mr. Glist, indulge us.

Dr. Owen, we normally take a morning recess. When we indulged your counsel and took the five minutes, we unfortunately spent all that time talking about your testimony. We need our regular morning recess, so we'll take ten minutes right now.

(Whereupon, the foregoing matter went off the record at 11:43 a.m. and went back on the record at 11:57 a.m.)

CHAIRMAN GRIFFITH: All right.

CROSS EXAMINATION (con't.)

MR. GLIST: I wanted to show you a selection from your Video Economics text. I'd ask for this to be marked as 31-X.

Just before the break, we were talking about whether there was evidence that television viewers generally prefer programs without commercials. I was paraphrasing from the middle of page 125. Do you see the middle of that center paragraph?

(Whereupon, the above-referenced document was marked as SBCA Exhibit 31-X for identification.)

THE WITNESS: Yes.

MR. GARRETT: Your Honor, is this being marked as another exhibit, or is this --

JUDGE GULIN: 31-X.

CHAIRMAN GRIFFITH: 31-X. He asked to have it marked.

BY MR. GLIST:

Q Dr. Owen, doesn't your text say payments of premiums for the cable use of remote controls, use of VCR's, independent station programming as some of the evidence that viewers prefer commercial free --

A It does. Clearly my co-author's work.

Q But suffice it to say that an economist with whom you chose to co-author this text found this evidence of viewer preference, is that correct?

A Yes.

Q And if that premise is given, can commercial time within the broadcast network signal be treated as a price that viewers pay to see programs supported by advertising?

A I don't know how you get from the one to the other. Now I answered the question before in terms of the opportunity cost. If they don't like it, and they could be doing something better that they would value more during that interval, then obviously there's an opportunity cost to it.

And if you characterize that as a price, that's fine. Of course, the same thing applies to all these blue guys. There's no difference between that and this.

Q The size of the audience is not a difference?

A No, I think when you talk about prices you have to talk about per unit. Every viewer of a basic cable network presumably feels the same way about advertising on that network as a viewer of the broadcast networks does.

To the extent that the people here are accurately characterized as paying a price for the advertising there because of the opportunity cost of their time, then why wouldn't the same thing apply to every viewer of a basic cable network?

Q Could the commercial television networks sustain their 1,800 million expenditures per year if they were exposed to an audience of half what they're exposed to today?

A No.

Q If you'd turn to the next page in the text, your text states "If viewers do not like commercials, then commercial time may be treated as a non-monetary price that viewers pay to see programs supported by advertising."

Is that not a sentiment with which you agree?

A At least in 1993 I did, yes.

Q So if --

A But that equally applies -- I mean, it doesn't say broadcast networks here, it says commercials. And it applies equally there and there.

Q Well, let's talk about this model then.

When you assembled your data, you did not have any broadcaster among these data points for license fees, right?

A No. Yes, that's right. No, I didn't.

Q Okay, and that's because single broadcasters don't get license fees from MVPD's, is that --

A Unless they're super stations, and then they get a fee that's set by the government.

Q In the over the air world, didn't broadcasters try single channel pay television called subscription TV or STV?

A Many years ago, yes.

Q Many years ago. And did that work out?

A There were several experiments. I think some of them were under experimental licenses from the FCC. And so whether or not they would have worked out may be a moot question. But generally they were not successful because of the cost of monitoring usage.

Q It just didn't work on a single channel arrangement then?

A It didn't work on a single channel arrangement because of the cost of keeping track of -- I mean, it may not have worked in those days -- we're talking the 60's -- even with multiple channel arrangement over the air because of the cost of the set top boxes that had to be employed.

Q And of course, the cost of those set top boxes have changed, hasn't it?

A I don't know who is making those particular boxes, but generally the cost of electronics has fallen, yes.

Q And the equipment exists to scramble an off-air signal, relay it out to boxes in a home, and unscramble it over the air, doesn't it?

A Whether it exists or not, it could certainly be produced.

Q But the commercial broadcasters have not followed that model?

A No.

Q Now, when you collected this data, you didn't put in the relationship between the broadcast networks and their terrestrial affiliates because I understand you just deemed that irrelevant to this analysis?

A Because there's no viewer payment.

Q Outside of the context that we just discussed?

A Yes.

Q And so what you do in lieu of putting in the network compensation arrangements is to make this extrapolation. You go through your various adjustments, draw a line, and then project it out to the program expense currently incurred by the commercial networks.

A Yes.

Q So it's extrapolating from the basic cable network market into the broadcast network market?

A As it would be if broadcasters could obtain subscriber revenue via satellite carriers.

Q Now aren't you assuming that simply by incurring these costs, the commercial broadcast networks will find a buyer at the rate that you predict?

A By a buyer, you mean a satellite carrier?

Q I think that's what you mean by it.

A Yes, sure. I mean, it's a pretty good assumption, after all. We know that the broadcast networks are very effective at generating viewing. People want to watch them, hence the ratings.

It seems perfectly reasonable to suppose that they would be very important sources of subscription revenue for the satellite carriers and that therefore, the satellite carriers would want to buy them.

Q But when the broadcast networks do their relations with terrestrial affiliates, they make advertising avails available and they work out these arrangements for network comp, don't they?

A I'm sorry, I'm not tracking you.

When they deal with their terrestrial affiliates, they're not dealing with people who have subscription revenue.

Q Okay. So we know that terrestrial affiliates are not paying $1.22 because you're saying they're -- they don't have subscription revenue, so we're not going to look at those, right?

A They're not comparable.

Q They're not comparable. And how about TV translators, are they paying $1.22?

You know what a TV translator is, don't you?

A Well, you better check me.

My understanding is that a TV translator is a television station that rebroadcasts a terrestrial station into a different part of the country on a different frequency.

Q Right. That's correct.

A Usually rural areas.

Q Yes.

A Okay.

Q And in those situations, the TV translators don't pay $1.22 to the networks?

A I don't know what they pay.

Q You didn't look at that?

A No.

Q And of course, we know that cable television doesn't pay $1.22 to the broadcast networks --

A Yes.

Q -- courtesy of the compulsory license?

A Right.

Q Right. And we know that wireless cable or MMDS doesn't pay it?

A I'm not clear how the compulsory license applies to them. I guess they don't.

Q And how about satellite master antennae or SMATV?

A There's more than just the compulsory license involved. And all of these people, to the extent they're rebroadcasting in the same territory, also have to contend with the fact that the subscribers could get it off the air. So they can't charge the same that they could if there were no off-air capability.

And therefore, their willingness to pay is going to be lower.

Q But the data -- we could assemble the data on the relationships between the commercial networks and their terrestrial affiliates, what cable pays, on what TV translators do -- we could assemble that data, and it would be empirical, wouldn't it? It wouldn't be --

A It would also be irrelevant.

(Laughter.)

Data are empirical. That's their nature.

Q You would prefer to go with this projection rather than looking at the existing arrangements that have been worked out in the marketplace today?

A But the basic assignment here is to estimate what the price would be if broadcast networks were free to sell their signals directly to satellite operators who obtain revenue both from advertising and chiefly from subscriptions and do so in an environment where there's no compulsory license, where there's no interference by government mandated copyright fees or license fees, and where there's no local over the air competition because we're talking about white areas, right?

So what's the most relevant basis of comparison? It's this one and not the one you've been describing.

Q But the $1,800 million dollars that the networks are spending, that's the money that they're spending to attract audiences for advertisers, is that right?

A Yes. And on the basis of advertising revenue alone, if they had subscription revenue, that number would be much greater.

Q You've done an analysis of how the commercial broadcasters would operate if there were no advertising revenue?

A I didn't say no advertising revenue. I said if they also had subscription revenue.

Q I thought we determined that you had not accounted for any possible change in the advertising relationships or the advertising sales or the sharing of advertising revenue that might develop between satellite carriers and commercial networks?

A I don't recall saying that.

What I'm referring to is the discussion in the report and also earlier today in my direct about what the effect of that $56 million dollars per year would be on the quality of network programming.

And I said that to the extent that expending more money on programming would draw in more subscription revenue from satellite carriers, there would be a tendency to compete away that revenue on higher quality programming; which is another way of saying this number would be higher.

Q As I recall your testimony on that point, you spoke in some qualified terms -- you said to the extent, or there's a tendency, of if they would compete it away.

You haven't done any analysis of what would happen with an additional sum of money, have you?

A The discussion in the report is the analysis that I've done.

Q You haven't talked with --

A There's nothing more than that.

Q Nothing more than that? You don't have commitments from executives or anything like that?

A No.

Q And the total programming expenditure to date in -- among the commercial networks is -- I think you say like $5½ billion?

A Well, it's $1,800 million times three roughly, whatever that is.

Q Does that work out to $5½ million?

A I'm terrible at that.

Q Can we say $5 billion?

A A round number. It depends on what your next question is.

Q And you're saying that an additional $56 million a year is going to affect the programming investment by the commercial broadcast networks?

A I think what I said, again, is if an increased program expenditure by networks produces increased revenue from subscriptions because of the ability to charge now, then there will be competition for those viewers. And the way the networks compete for those viewers, aside from the price, is through program quality.

So there will be a tendency to compete away some or all of the $56 million.

Q And did you make any effort to see what the commercial networks actually do with infusions of new money; whether they plow it back into programming or paid evidence -- did you look at that?

A Well, I don't know that I have specifically in the context of this project. But, you know, every year the size of the audience gets bigger, there's more people, and advertising budgets go up, and the networks get more revenue.

And I haven't noticed that they get to keep it all.

Q Well, let's take a look at the Olympics. You recall NBC's experience with the Olympics last year?

A No.

Q No? Well, let's test your hypothesis about the tendency of this money.

I ask that this be marked 32-X.

Dr. Owen, is Broadcasting & Cable magazine a source of information that you consult in your profession?

(Whereupon, the above-referenced document was marked as SBCA Exhibit 32-X for identification.)

A Well, I read it.

Q Would you take a look at the second page in which there is a report on Olympic revenues for NBC?

Do you see where it says that the summer Olympics contributed $650 million to the network's 1996 revenues?

A No, I don't see. Where are you?

Q Page five of Broadcasting & Cable, bottom of the carry-over column.

A Okay, I see where it says that.

Q Okay, so would your testimony be that if there was such an infusion of $650 million, that there would be a tendency to compete that away and turn it over to program suppliers?

A Exactly; to the extent that this is accurate information, and to the extent that the networks regard it as an accurate way of predicting what the profits would be from future Olympics, when they're bidding on Olympic rights in the future, they'll tend to bid more in order to get these profits.

And so they'll tend to pay more for the programming. That's exactly my point.

Q Well, let's look at what was actually done.

This should be 32-X. 33-X, excuse me.

Isn't this a report that GE earnings hit record levels -- that the company attributed it in part to the summer Olympics and then increased their dividend to record levels?

(Whereupon, the above-referenced document was marked as SBCA Exhibit 33-X for identification.)

A You want me to adopt this as something I know, or do you want me to say that's what it says?

Q Well, let's start with whether that's what it says.

A Apparently, yes.

Q Now would that not indicate that rather than plowing this back into programming, it was paid out as a dividend to GE shareholders?

A Well, I think I just tried to make the relevant point here which is to the extent that there was a unexpectedly large profit from the Olympics, and to the extent that the broadcast networks regard that as indicative of the profits to be made from future Olympics, there will be a tendency to compete away that profit in higher rights payments for future Olympics.

It's not going to get competed away when it already happens. That was a windfall.

Q That was a windfall?

A It's only to the extent to which the -- it's not indicative of future events that it affects program prices.

Q So when $140 million comes in -- if your $1.22 rate holds, it doesn't get competed away immediately; it might simply flow through the dividend?

A It's hard to answer that because it depends on expectations. When selecting programming, when deciding how much to bid for rights, the broadcast networks rationally look at their expected revenue -- the effect of that on their expected revenue, right?

Now, if the $56 million is something that drops out of the sky on them unexpectedly, they're going to keep it. There's no doubt about that. But to the extent it is anticipatable and can be affected by their programming choices, then they can't do that.

They don't get to keep it.

Q Let's go to -- go back to your model.

Page 48 of your testimony contains some of the data points that you use in compiling these graphs, is that correct?

A Yes.

CHAIRMAN GRIFFITH: Yes?

MS. WOODS: I'm sorry, Mr. Glist is fading out again.

MR. GLIST: I'm sorry, I'll keep my voice up.

MS. WOODS: I recognize that after this hearing I have to go get my hearing tested.

MR. GLIST: I'll try to accommodate.

MS. WOODS: Thanks.

BY MR. GLIST:

Q Let's look at the Travel Channel. For 1995, it reports program expenditures of $11 million?

A Yes.

Q And license fees are almost negligible, aren't they?

A They're very small.

Q Very small. Wouldn't this indicate that this particular channel is almost entirely advertiser supported?

A Most likely.

Q And the resorts and the airlines are trying to reach viewers, and they'll advertise on Travel Channel?

A Most likely.

Q Well, let's look at WTBS or TBS as it's shown in upper -- on the same page.

A Right.

Q It shows program expenditures of what, $155 million?

A Right.

Q And license fees of zero?

A Well, but license fees aren't set by the market. They're set by the copyright process and the government.

Q Right. But -- and that means that WTBS is entirely advertiser supported?

A Close to it.

Q Close to it? And this is the biggest super station in the U.S., right?

A I'm not sure whether it is or not. It's certainly among the biggest.

Q Among the biggest. The distribution to, what would you say, 60 million cable homes?

A I think super station penetration has been falling in recent years. I doubt that it's that high, but I don't know.

Q You don't know?

But you would agree that WTBS is distributed nationally on --

A It's certainly available nationally, yes.

Q Available nationally?

A To the cable systems.

Q Right. And so their economics is

organized to be entirely advertiser supported and there is no license fee?

A Well, you're reaching that conclusion as if the fact that there's license fee is a market outcome. It isn't.

Q Okay, then let's look at QVC.

You don't have any shopping channels on here, do you?

A I hope not.

Q Well, why isn't a shopping channel live QVC included in the model?

A Because it's a different kind of network than the broadcast networks. It's not comparable. Shopping channels sell merchandise to the people who watch television in incredible numbers, and they share the revenue from that with the cable operator. So the flow of revenue is from the shopping channel to the cable operator.

Q They have to get their infomercials out to the audience, so they pay the cable operator for distribution, right?

A Their share of the revenues that they get from selling their commodities, yes.

Q But under your model on page 43, shouldn't they be charging a license fee of eight cents plus some part of the cost of producing those infomercials?

A No.

Q No? Because you left them out of the analysis.

A No, because it's not appropriate to extrapolate from these basic cable networks which sell both advertising and services to subscribers to the shopping networks which don't do that.

Q Oh, because you don't want to extrapolate this backwards into an arrangement where a basic cable network pays the cable operator for distributing infomercials, but you want to project it forward to pay a license fee to networks that want to distribute advertising?

A No, it's because I don't want to apply it to something that is inappropriate.

Shopping channels are not the same as the basic cable networks in the way they do business. It's not the same business model.

Q Okay. And commercial broadcasts, are they the same as basic cable networks in the way they do business?

A No.

Q According to your model then, suppose I'm sitting in the middle of this pack down here somewhere, the Nashville Network, okay? If I were the Nashville Network and I increased my program expenditure 100 fold, then I could plug into this formula and command -- I'd find a buyer somewhere out here at this price, right?

All I've got to do is spend the money?

A Effectively, yes.

Q All I have to do is spend the money and they will come?

A Expend it effectively, they will come; yes, exactly.

Q But why doesn't TNN do that? It's owned by a broadcast network, isn't it?

A Why doesn't TNN do that?

I suppose it doesn't do it because of the constraints offered by the channels that it has available to it through which to sell. I mean, there's a little bit of a capitalization problem. In order to put out $1,800 million dollars worth of investment in programming, you have to come up with the money to do that.

Q But it's owned by the networks that you're speaking for.

A I don't understand the relevance of that.

Q Well, I thought that they could raise the capital to buy the programming, and you're projecting what license fee that they could obtain. So why don't they do it through TNN?

A There's a variety of reasons, one of which is -- if you're suggesting that they could put their programming on TNN, this programming, the answer is they don't have the right to do that.

Q Just the dollars. All they've got to do is spend the dollars and buyers will come.

A If they spent the dollars effectively and bought programming that was effective in raising audiences, right, and it was attractive to viewers as the network programming is, then the fees would be in that same range, yes.

I'm not pretending that if they spend $1,800 dollars on old movies that they could do that. It has to be effective programming; programming comparable to this programming.

Q Because just spending the money doesn't really deliver the audience, does it?

A No, I think you should understand that this -- spending the money in this context of this model means in the context of a market -- competitive market process; a process where spending the money produces a result in terms of profits. And people who are not effective in generating profits go out of business.

Okay, and this relationship down here is not just a simple -- you know, put money in, get profits out relationship between expenditures and license fees. It's the whole process by which cable networks compete with each other.

Q Okay, well a lot of these in the cluster down here down in the pack, they're owned by Time Warner, right?

A There are some, yes.

Q Some? Okay.

Well, Time Warner is a substantial company, isn't it?

A Yes.

Q It has interests in all sorts of media production and distribution?

A Yes.

Q Well, if this was correct and it predicts market results, why doesn't somebody like Time Warner which is in this business just start spending money like crazy on the basic cable nets that they already have carried on cable?

A Because to do so would be unprofitable in the environment that they operate in.

Q It would be unprofitable in the environment in which they operate in, which is multi-channel video programming?

A With limited subscribers.

Q And we already discussed that when the broadcast networks themselves launched retransmission channels like ESPN-2, they didn't buy into this model either. They didn't just shift their broadcast network programming over to ESPN-2 and charge $1.22?

A No, they didn't. They don't have the right to do that.

Q If they had thought that the model worked, wouldn't they have bargained for those rights?

A The sellers of the programming have to decide how much they want for those rights and whether or not the broadcast networks are the ones that are willing to pay the most for them.

Q So it's not at all clear that in the market the television broadcast networks could actually assemble rights to their entire feed and sell it to satellite carriers?

A Their current feed?

Q Yes, their current feed.

A I think that's right.

Q Okay, I wanted to go back to the margin of error, I think is what we call it.

It's this plus or minus 55 cents, is that right?

A Yes.

Q Isn't that a pretty big margin in a royalty that just got adjusted last time by three cents?

A I'm not responsible for what the government does. I'm talking about what the market does.

I mean, I do think you need to understand that we are extrapolating a long way out from the original observations. And it is inherent to the nature of these things that when you do that, the further out you go, --

Q The less certain you go.

A -- the bigger the confidence interval has to be.

Q Right. And did you testify -- I don't remember you assigning a percentage of probability to this point. Is that like less than 55% probable --

A I don't know what it is.

Q You haven't calculated what that is?

It's a bulge, but it could be down there?

A Well, we know that 95% of it is between $1.77 and 80 cents or so.

Q I mean, it could be 30% probable, but more than 22 or 20, right?

A $1.22 is the most likely number.

Q More likely because there is a slight curvature of the earth, right, and that is point -- is a little --

A How flat or steep that is has nothing to do with it. It's more likely.

That's the best I can do. Best anybody can do. It's the nature of the problem.

Q It's the nature of the problem produced by your projection?

A No, it's not.

The nature of the problem is that the closest comparable transactions are much smaller.

Q Well, right. If you define this as comparable transaction instead of network comp, then you have this problem?

A Yes. I think it's perfectly obvious that network comp is not comparable or remotely comparable.

Q Another thing about this 55 cent margin of error.

Isn't that even bigger than the value that's been assigned to network affiliates by the other owners in this room?

A I'm not following you.

Q Well, do you know what, say, Joint Sports has said the value of a network affiliate is?

A I don't remember the number. I looked at the testimony, but I don't remember what the number is. But it's certainly much smaller than $1.22.

Q And does 35 cents ring a bell?

A Could be.

Q Could be?

If 35 cents were the value that sports had assigned to a network affiliate, that --

MS. WOODS: Objection, Your Honor.

I have concern about the use of terminology. I don't believe any of the copyright owners assigned values to network affiliates per se.

MR. GLIST: Indeed, they did, if you look at their submissions. They asked for a rate applicable to super stations and network affiliates.

MS. WOODS: I'm just concerned about

mixing up the programming that we're talking about here whether it's the national programming that's being discussed in this study versus all of the programming on the network affiliate.

I understand that the -- that most of the parties have asked for a rate --

CHAIRMAN GRIFFITH: Right.

MS. WOODS: -- of 35, 36, and 38. But I'm concerned about using the terminology network affiliate.

MR. GLIST: It's their direct case.

CHAIRMAN GRIFFITH: The objection is overruled.

BY MR. GLIST:

Q If Joint Sports claims that the value of a network affiliate is 35 cents, that's smaller than even your margin of error.

Doesn't that suggest that we -- we can't put a lot of stock in this $1.22?

A No. As I understand it, the 35 cents, if that's what the number is, was a minimum estimate as opposed to my best single number estimate. And further, it explicitly does not account for quality.

Q It does not account for --

A For quality, program quality.

Q Program -- by which you mean expense?

A Yes.

Q Well, how about then the Fox television network; you are not speaking for them, are you?

A No, except indirectly.

Q Indirectly?

A In the sense that something can be implied about their situation from this.

Q And what would one imply from their removal from your case?

A Removal?

Q Well, you're speaking, I thought, for ABC, CBS, and NBC?

A Yes.

Q And Fox is not endorsing $1.22?

A I have no idea what they're doing.

Q But they have not told you you're speaking for me?

A No.

Q And this is the network that has the Super Bowl, right?

A Last year, yeah.

Q X-Files?

A Yes.

Q But they're not joining in the $1.22?

A I don't know what they're doing.

Q Dr. Owen, on page 18 of your testimony, the last sentence of the page says, "We are aware that at least two local network affiliates now allow a satellite carrier to insert national advertisements in place of the station's local spots before the stations are retransmitted to subscribers."

Do you see that?

A I do.

Q Which networks are we talking about?

A I wish I could remember. NBC and somebody else. I don't remember.

Q Do you now how much advertising is being replaced?

A No.

Q Do you know what the fee arrangement is among the parties?

A No.

Q If you were looking for a marketplace transaction, wouldn't you be obligated to study that in more detail to see what the parties actually do?

A Why is that representative of this free market transaction? It has nothing to do with that. This is a compulsory license.

Q It has nothing to do with your particular extrapolation, but it's highly relevant to how players behave in the real world, isn't it?

A No, it's not. In a market situation, there is no compulsory license. There isn't.

You get to withhold the program if they don't pay for it.

Q Are you at all familiar with how WTBS distributes its feed for retransmission to cable homes?

A Not in detail, no.

Q Do you know whether they, WTBS, replace local ads for Atlanta DMA with national ads for the national market?

A I don't know.

Q You don't know that?

A No.

Q So you didn't look at what models of cooperation and advertising might have evolved in the big dog, the cable universe?

A There's a license fee that's set by the government for the super stations. That's not a free market environment.

Q In the case of satellite carriage, is it your understanding that the carrier itself has to carry the signal intact?

A I'm sorry; do that again.

Q In the case of satellite carriage of a broadcast station, is it your understanding that the carrier has to carry the signal intact?

A I think that's right.

Q So if your testimony is right that NBC and someone else allows a satellite carrier to insert, wouldn't it have to be the network that is doing the swapping out?

A The network has to be given permission for it, yeah.

Is that what you mean?

Q I mean, the carrier has to carry the feed that's delivered to it by the broadcast network --

A But that's a right as against the network.

Obviously that right can be waived. That's just the right established by law. If the network and the carrier agree to do something else, then obviously they're free to do that.

Q Okay, but you didn't look at what the terms of that arrangement were to find out how people would swap out commercials for a satellite feed?

A No, it wouldn't be relevant to look at that because underneath that arrangement, underneath whatever transaction is going on there is a compulsory license to take the feed as it is.

Q Okay, but the compulsory license is to take the feed as it is. So a network would have to consent to doing anything else with the feed, wouldn't it?

A Yes.

Q And so in the process of that consent, couldn't it negotiate the correct rights between the parties?

A No. Because underlying the negotiation is the compulsory license.

Q The compulsory license which would say take my feed intact. But if the network wants to work with the carrier as a willing seller, he can do something on top of that, can't he?

A If the network says please give me a $1.22 because that's what my signal is worth, what the satellite carrier will say is no, I'm just going to take it intact under the compulsory license and pay you essentially nothing.

That's not a free market transaction.

Q You don't -- okay.

I understand you don't report that as a regard that as a free market transaction.

A I'm glad I got the point across.

(Laughter.)

Q Is it your conclusion that the current fee is way too low?

A Yes.

Q And how large is the current satellite royalty pool?

A Satellite royalty pool?

Q How much do the satellite carriers pay in royalties for the carriage of broadcast signals?

A I don't know.

It can't be very much given the level of the fees.

Q But you didn't look at that when you were projecting what the effect on the broadcast network behavior would be in the dual revenue stream world?

A I don't understand why that would be relevant.

Q Well, --

A What has the pool of revenue that result from government imposed fees that are too small got to do with predicting what the market would look like without government constraints?

Q Well, I thought that your testimony was that give me a larger amount of money, and then I will then have the tendency to bargain that away and benefit all viewers with better quality programming.

Isn't that what you testified to?

A Well, that greatly oversimplifies what I said.

I mean, we can turn to it and see what I said, but -- should we read it?

Q If you would like to, yeah.

A It starts on page 36. That's what I said.

Q What is it that you said that's different from what I just tried to summarize?

A I didn't think that what you said was an accurate summary, but I don't rightly remember what you said.

(Laughter.)

Q Okay, let me -- let's get back on the main track then.

You don't know what the current royalty pool is -- you deem that irrelevant to your analysis of what the market would dictate?

A Yes.

Q Okay. And I would infer from that that you also don't know what the networks take out of that pool today?

A That's correct.

Except that it can't be very much.

Q Do you know how big the cable television royalty pool is?

A No.

Q So you have not made any effort to compare what royalties satellite carriers would pay under your proposal as compared to what the cable operators might pay under their compulsory license?

A I can't imagine why they would want to do that.

Q Well, are satellite carriers and cable operators competing for some of the same customers?

A Well, remember we're talking about white area viewers, so they're not competing with a great many of the same customers.

Q Well, how many white area customers of satellite carriers are off the cable grid?

A I would have thought most, but I don't know what the number is.

Q You haven't looked at that?

A I don't know that it's available.

Q Now you also have testified I think on the prior page that ASkyB -- oh, maybe it's 34. Somewhere you testified about a bid for satellite spectrum, do you recall that?

A Yes, MCI.

Q And from that, you were deducing something about the financial health of the satellite carrier industry, or what were you deducing from that?

A I was trying to compare the various measures of the expected future profits from being in the satellite business with the flow associated with the $1.22.

Q So you were using that as a benchmark from which to infer future profits?

A If nobody's going to be willing to pay $700 million dollars for the right to use an orbital slot unless they expect to get at least that much in discounted present value of future profits.

Q Or if they're willing to take a risk on it?

A Well, it's inherently risky.

Q It's inherently risky.

Do you know -- did you look to see whether any of the DBS carriers, for example, are cash flow positive or profitable or anything like that today?

A Well, we looked at the various analyst reports on the industry. I'm not so much concerned about what they are today as what the future is like.

Q The future being what --

A For the next few years.

Q So do you know what the profitability will be in 1999?

A For the industry as a whole? No.

Q Do you know what it will be for DBS carriers?

A No.

Q Do you think that the financial health of a seller would affect a marketplace rate agreed to without compulsory license constraints?

A Well, the value -- fair market value is something that's supposed to be between a willing buyer and a willing seller, neither of which is compelled to do something. And if the question is intended to imply that the seller is compelled to sell, then obviously it would affect it.

But that's not the relevant criteria.

Q I was trying to ask you in the absence of a compulsory license whether the financial health of a seller would affect --

A That was the question I tried to answer.

Q And your answer was that it would or would not?

I must have misunderstood you somehow.

Q My answer was that -- what we're trying to get at here is a fair market value, market value for what broadcast signals are worth. And that involves what a willing buyer would pay a willing seller, neither being under compulsion to buy or sell.

Right, that's the standard definition of what fair market value is?

And your question implies that the seller is under some sort of compulsion, financial compulsion, to sell. So if that's the question, then yes, it could affect the value, but not the fair market value.

Q No, I'm asking whether absent compulsion, the financial health of the seller affects the --

A Financial health is a form of compulsion is the point I'm trying to make.

Q Financial health if a form of compulsion?

A It can be.

If I'm on the verge of bankruptcy, I might need to sell assets.

Q I see. And if --

A For whatever they'll get.

Q And so if a satellite carrier is in financial distress, what is the consequence of that?

A I don't know.

Q How does that affect the bid and ask price?

A Change from seller to buyer now, right; satellite carriers being the buyers of these rights?

I just want to be sure I'm tracking the question.

Q We'll go back to the seller because I'm not clear on what financial health has to do with anything.

A You asked the question.

Q I'm trying to get an answer.

A Okay, I'll answer it this way.

Financial health has nothing to do with fair market value.

Q Okay.

A As I understand the term.

Q Are you assuming that there is -- I think in your oral direct you said a huge profit in the business? I think you were saying well these guys, they get it for six cents, and they sell it for something higher than that; that's a huge profit?

A Yes.

Q When you say huge profit, are you looking into any of the costs that a satellite carrier incurs for distributing its product?

A Well, the variable costs that a satellite carrier has are going to be the license fees.

Q Those are the variable costs. I'm asking if you accounted at all for fixed costs.

A Oh, I mean, that's not -- it's the profit on the margin that counts, right?

And if you add a satellite -- a broadcast signal and you had to pay six cents for it and you get to charge a dollar or whatever, right; on the margin, that's a very large profit. And you don't diminish it by saying oh, yes, but I paid a billion dollars for the satellite.

You had to do that anyway. It's sunk.

Q I see. So you're not looking into the opportunity costs of using a channel or anything else like that?

A Well, satellite carriers don't have yet a lot of opportunity costs from using channels because they have so many channels.

Q PrimeStar?

A PrimeStar has got fewer until recently. Now it's got close to 200.

Q Not up yet.

A I thought it was up but not operating. Operating in June? The modern ones have around 200 channels.

Q Okay, so when you say profit, you just mean something about variable cost, that's what you're looking at?

A On the margin, they are extremely profitable, yes.

Q But in terms of an enterprise, you're not testifying whether a DBS carrier is profitable or not?

A No.

Q If this business is likely to be profitable, why haven't the commercial networks themselves entered the business?

A Well, I can only speculate about that.

I mean, one possibility is that they haven't entered it because they don't think they can compete successfully with the likes of Rupert Murdoch. That's a possibility.

Another possibility is that they think that if they were to enter this business, they would face political difficulties because of the importance of free television to our national psyche. There may be other possibilities. I just don't know.

Q There's a constitutional right to free TV somewhere, right?

A Some people seem to think so.

Q Okay. The last thing I wanted to ask you about arises on page 12 of your testimony --13, I think that's it, 13; top of 15.

It says, "The fact that we do not see any voluntary agreement below the current statutory rate indicates that the rate is below fair market value."

A Yes.

Q Okay, but I thought that you told me earlier that the networks don't have the rights to clear in the satellite market.

A They don't have the rights to clear absent the compulsory license. I'm going to step into an area which is a legal issue. I don't -- I shouldn't do it. I don't know the answer.

This statement is based on the assumption that if the copyright royalty fee was set at a number which was too high -- okay, $8.00 per subscriber per month, some number that's way too high -- that the parties would be free to negotiate a lower rate under the compulsory license.

Now, I don't know whether that's legally correct or not.

Q Do you know whether the networks have put themselves in the position of being able to enter into such private licenses for their broadcast stations?

A With respect to satellite carriers?

Q Yes.

A No, I don't.

Q But with respect to the cable networks that they own like ESPN-2, they know how to do that, right?

A I assume they know how to do it generally.

Q And they've done it? They've done it for ESPN-2?

A For ESPN-2, they have cleared the satellite rights to the programs in order to sell it to satellite carriers and cable systems.

I don't understand your point.

The ABC programs are not cleared.

Q The ABC programs --

A Whatever they are, they're not ESPN programs. They different programs.

Q Okay. Now you've said that if they adopt the $1.22, it's not going to have much of an impact, and you offered some various reasons for that on direct.

I wanted to ask you -- did you do any price elasticity study of satellite homes?

A No.

Q Okay, let's suppose that you get a rate of $1.22 for the commercial networks. Then if the carriers don't pass it through and they just pay you that rate, suppose that the margin of error is so big that it really is above market, okay; the networks get money that they're not entitled to under your market analysis, right -- $1.22 is off if it's above market?

A If $1.22 is above the correct market value, yes.

Q They get money they're not entitled to?

A Entitled is kind of a non-economic term, but it's above market.

Q Okay, well suppose that you're really way off and the $1.22, no buyer's going to do it. The carriers just won't buy it.

A Right.

Q Okay, and they're waiting for the networks to renegotiate their contracts to a private license that's below market.

A If they have to.

Q If they have to.

They drop the signals, okay, because they're not going to meet that -- that's not a market price, they won't pay it. How long is it going to take the networks to renegotiate the contracts?

A Wait a minute.

Are you trying to say that the networks couldn't simply accept a lower fee for the intact signal?

Q If it's --

A No, that doesn't make any sense.

Let's suppose $1.22 is 50 cents higher than the correct market rate, okay? And so the satellite carriers drop the signal, right? Why can't the networks just accept 70 cents or whatever the --

Q They don't have the rights to clear it.

A But the satellite carrier would be operating under the compulsory license.

Q They would be saying pay $1.22 on your statements of account to the Copyright Office. They go in with a statement of account to the Copyright Office, and they say I can't do $1.22; I want it to be 12 cents; here's my 12 cents.

The Copyright Office says I can't take this. The CARP said it's $1.22. You're not meeting the statute. Okay, so they can't offer 12 cents.

A I don't know. I regard this as an entirely legal question. I can't help you.

Q Okay, just indulge me my premise that I actually know whereof I speak on this issue just for that -- for this moment.

(Laughter.)

I set myself up.

MR. SEIVER: What goes around comes around.

BY MR. GLIST:

Q If the broadcast networks had to negotiate -- renegotiate their program supply contracts, how long would it take for them to be able to clear the feed to the satellite home?

A I don't know.

Q And in the meantime, however long that takes, the satellite homes would be without network signals?

A Sounds like a doomsday scenario to me.

MR. GLIST: I have no other questions.

CHAIRMAN GRIFFITH: All right.

We'll take our luncheon recess. I'll ask you to be back at 2:00, please.

(Whereupon, the proceedings were recessed for lunch at 12:53 a.m.)

A-F-T-E-R-N-O-O-N S-E-S-S-I-O-N

(2:01 p.m.)

CHAIRMAN GRIFFITH: Mr. Stewart, do you want to cross examine, sir?

CROSS EXAMINATION

BY MR. STEWART:

Q Dr. Owen, good afternoon.

My name is John Stewart, and I'm here representing the Broadcaster Claimants group.

A Good afternoon.

Q Dr. Owen, you talked during your cross examination with Mr. Glist about retransmission consent negotiations. Do you recall that?

A Yes.

Q Now that was retransmission consent in the context of local cable systems carrying the local network affiliates in their own markets, is that right?

A That's right.

Q Now are you aware, Dr. Owen, of whether that retransmission consent is negotiated within the context of FCC regulations?

A My understanding is those negotiations took place in the context of some statutory scheme.

Q All right.

A Some communications law scheme.

MR. STEWART: And I'd like to have this marked as Broadcaster Claimant's Group Exhibit 1-X

(Whereupon, the above-referenced document was marked as Broadcaster Claimant's Group Exhibit 1-X for identification.)

CHAIRMAN GRIFFITH: Is he X or just one?

MR. STEWART: This is 1-X because it's cross examination.

CHAIRMAN GRIFFITH: Oh, it's cross examination.

MR. SEIVER: I'm sorry, are we distinguishing them by the same broadcasters, 1-X?

MR. STEWART: Yes. I believe that's what the --

BY MR. STEWART:

Q Now this, Dr. Owen, is three pages copied from the annotated version of the Communications Act. I have the whole volume here with me. And it is the portion within which the due transmission consent statutory provisions in the Communications Act that you just referred to are included.

And if you'll turn to the second page of this exhibit, down at the bottom right-hand corner there, you'll see under Section 325(b) the current version of the retransmission consent provisions.

Do you see that?

A Yes, I do.

Q All right, now we won't go through the (b)(1) which is the basic retransmission consent requirement. I want you to focus your attention on (b)(2) there. Do you see that?

A Yes.

Q Would you read into the record the line that follows the number two there, and then the line that follows the (b) below that?

A "The provisions of this subsection shall not apply to (b) retransmission directly to a home satellite antennae of the signal of a broadcasting station that is not owned or operated by or affiliated with a broadcasting network if such signal is retransmitted by a satellite carrier on May 1, 1991."

Q All right, so the Communications Act says retransmission consent doesn't apply to a non-network station, a super station, if it was carried by satellite carrier as of May 1, 1991; is that correct?

MR. GLIST: Objection.

I thought this witness testified that he had a limited legal understanding of retransmission consent and he spoke to the extent of his knowledge. He's simply reading into the record a statute as to which he's not an expert.

CHAIRMAN GRIFFITH: Mr. Stewart, do you want to respond, sir?

MR. STEWART: Yes, Your Honor.

We've had several references to the retransmission consent by Mr. Glist or the Satellite Carrier's counsel, and I think it's absolutely critical for us to have clear in the record what that is as a Communications Act policy.

And my questions of this witness, since he was asked about them, are simply going to be to have him specify what the provisions of this statute are.

CHAIRMAN GRIFFITH: You've just asked him, however, to interpret what it means, have you not?

MR. STEWART: I've asked him to -- yes, that's correct.

CHAIRMAN GRIFFITH: The objection is sustained.

MR. STEWART: Thank you.

BY MR. STEWART:

Q Would you turn to the third page, Dr. Owen, and read into the record the language that appears at (c) at the top left-hand side of page three.

A "Retransmission of the signal of a broadcasting station that is owned or operated by or affiliated with a broadcasting network directly to a home satellite antenna if the household receiving the signal is an unserved household or" --

Q Thank you.

Now turning --

MR. GLIST: If there's no question, then

I move to strike the last exchange. Reading a statute into the record from a witness who has no expertise in it, I don't think that nets us anything in this area.

Mr. Stewart has his briefs to do that.

CHAIRMAN GRIFFITH: Mr. Stewart?

MR. STEWART: Your Honor, again, I guess I want to make sure that the Panel hears evidence about retransmission consent regime to have clearly in mind what the statute provides with what -- that this is Communications Act, not a Copyright Act issue, and what the exemption are.

If the Panel would prefer, I would -- I can move to have this admitted as evidence as my official notice.

CHAIRMAN GRIFFITH: I think that might be more appropriate.

The objection is sustained.

Now do you want to move to have that admitted?

MR. STEWART: Yes, Your Honor.

I'd like to move at this time to have admitted into evidence Broadcaster Claimant's Exhibit

1-X as a matter of official notice.

CHAIRMAN GRIFFITH: All right.

Any objections?

All right, received without objection. Thank you.

(Whereupon, the above-referenced document, previously marked as Broadcaster Claimant's Group Exhibit 1-X for identification, we received in evidence.)

MR. STEWART: Thank you.

BY MR. STEWART:

Q Dr. Owen, looking next at your study that you presented in these tables in your direct testimony, the analysis you performed looked at the program expenditures or costs on a channel by channel basis, is that correct?

A For the basic cable networks, yes.

Q All right. And with respect to the broadcast networks, you looked at the total expenditure by the networks for all the programs that each presented on average?

A I looked at the average expenditure for the three major networks, yes.

Q Now did your analysis -- did you perform any separate analysis with respect to the program costs for any particular program?

A Any particular program?

Q Yes.

A No.

Q You didn't break down the channel or network total program costs program by program, is that right?

A That's right.

MR. STEWART: Thank you. I have no further questions.

CHAIRMAN GRIFFITH: All right.

Any other cross examination?

All right.

CROSS EXAMINATION

BY MR. LANE:

Q Dr. Owen, I'm Dennis Lane. I represent the Program Suppliers.

Could you turn to page 43 and 44 of your testimony, please?

And this is where you talk about the eight cent adjustment for advertising, is that correct?

A That's correct.

Q Now in -- is it your opinion that the Panel must make an adjustment for advertising insertions?

A No.

Q Under what circumstances would an adjustment like that be necessary in your judgement?

A An adjustment like that would be necessary to the extent that the satellite carriers were paying systematically less than the cable MSO's for the same basic cable networks on account of the fact that the satellite carriers don't or can't insert advertising into the available slots on the cable network program; and therefore, the same would presumably apply to the broadcast networks.

In other words, the value of these cable networks to cable systems is partly derived from the fact that they can put some of their local advertising on those channels. Satellite carriers apparently don't or can't or haven't -- but maybe they're starting to. As I understand the facts, that's about what it is.

If you were to assume that satellite carriers don't, can't and won't in the future insert commercials, and these numbers may be overstated as applied to satellite carriers, okay; and that would also mean that our projection is overstated as applied to the satellite carriers; and the adjustment that's been generally accepted for that in these proceedings up to now is this eight cent number, I don't know as a matter of fact that that number is even appropriate.

Q And isn't it true that in your testimony you indicate that you're aware that satellite carriers are allowed to insert ads on at least two network affiliate stations that they carry?

A Yes, and that's relatively recent.

Q So that's --

A And I'm also aware that on some basic cable networks they insert ads.

Q So there's no systematic denial of that right to the satellite carriers of which you're aware?

A My understanding of the trend is towards those insertions.

Q Thank you.

MR. LANE: Those are all the questions I have.

CHAIRMAN GRIFFITH: All right.

Any other cross examination?

All right, redirect?

MR. OSSOLA: I have a few, Your Honor.

CHAIRMAN GRIFFITH: Yes, okay.

REDIRECT EXAMINATION

BY MR. OSSOLA:

Q Dr. Owen, Mr. Glist asked you about the network compensation; do you recall?

A I do.

Q Why, in your view, is network compensation not a comparable transaction to consider in your analysis?

A Well, you recall network compensation is the difference between the flow of money that the stations are paying for the programs and the flow of money that the networks are returning for the advertising sales that they're making on behalf of the stations.

That's not an adequate or comparable measure for purposes of trying to figure out what this number should be for a variety of reasons; the most significant of which is that the local stations are not selling this stuff to subscribers. They're just depending on advertising.

Whereas these revenues are predominantly from subscriptions. And if the local stations are not dividing revenues from sales to actual viewers who value this programming much more than advertisers, then there is simply nothing comparable about the implicit price that they're paying for the programming when they pay the networks.

Even if compensation payments were the price, which they aren't, then they still wouldn't be a useful comparative standard because they're in an advertising only world and not in a world where there's both advertiser and subscriber support which is the world of the satellite carriers that we're trying to understand.

Q So did you consider at all network compensation in this scheme?

A No; except to reject it.

Q With respect to the projection of a $56 million dollar increase, and I guess looking at 1998 and 1999, --

A Yes.

Q -- do you know who would have the right to share in that increase?

A My understanding is that the revenues from this generated by the results of this proceeding go to the owners of the programs involved, the copyright owners. And the $56 million dollars would go to the owners of the copyright reflected in the network programming.

And that means that the sports leagues would have some share in it, other program copyright owners would have some share in it, and the networks themselves would have some share in it. I don't know what the fraction is that the networks themselves own, but it's relatively small.

So the $56 million dollars would go to various copyright owners including, but not limited to, the networks.

Q And how would those proportions be determined, do you know?

A By yet another proceeding.

Q Mr. Glist asked you about the potential for an increase in the -- for the consequences of the increasing cost for programming that would be paid by satellite carriers under your estimate.

Do you recall that?

A Yes.

Q Would that increase in programming cost have any effect on the number of channels?

A I don't think so.

Q Would it have any increase -- any effect on the number of satellites?

A No, I don't think so.

Q Why not?

A It's just too small. I mean, the numbers that are being -- the numbers that are relevant here are the magnitudes of dollars that are being invested in the satellites and in the capacity to carry channels.

And we're talking billions of dollars. The Murdoch-Sky project is eight satellites, three plus billion dollars. And $56 million dollars spread over the entire industry, not just Murdoch, is simply not big enough to have an impact.

Q Do you recall that Mr. Glist asked you whether you had performed a price elasticity study?

A Yes.

Q What is a price elasticity study?

A It's an attempt to understand what the effect would be of an increase or decrease in price on the number of subscribers in this context or generally the quantity demanded.

Q Why did you not perform such a study in connection with your work on this project?

A It wasn't relevant to the analysis that I was doing or the impact on satellite carriers.

If you call, what I did was to say let's take this $56 million dollars a year and take two extreme assumptions. One is that they pass it all on to subscribers, and the other is that they absorb all of it.

And taking either of those two extremes, I concluded that there would not be a significant adverse impact on the satellite carriers, whichever of those, if either -- well, actually, it's got to be in the middle somewhere -- was the outcome.

So worrying about the elasticity -- let me take it a step further. Two extreme possibilities with respect to what happens if they pass it on entirely. One is that because the price of network programming is getting increased, nobody wants to subscribe. Okay, so they lose those subscribers.

Now what does that mean? That means they won't pass it all along not because the networks are very important to the satellite carriers. The other possibility and the one that's far more likely is that the demand by subscribers, by viewers, for these satellite signals in white areas is very inelastic.

That is, not very sensitive to price. That is, if you increase the price somewhat, most of them would still subscribe because these are important signals that they're willing to pay to get.

Q Mr. Glist asked you some questions about the home shopping networks.

A Yes.

Q Do you recall that?

A Yes.

Q And do you recall that he asked you about the -- whether or not shopping networks compete with cable?

A Yes.

MR. GLIST: I don't believe I asked that question.

MR. OSSOLA: Well, I'm not sure -- I mean, the witness has answered the question, but I'm not sure -- I didn't intend to mislead him.

CHAIRMAN GRIFFITH: Go on. Let's hear what the next question is.

BY MR. OSSOLA:

Q Do you recall that you said that the home shopping networks were not in the same business as cable?

A Something like that, yes.

Q And I believe that Mr. Glist also asked -- suggested that the networks were not in the same business as cable.

A Something like that, yes.

Q Can you explain where you ended up there, what you meant by that?

A Mr. Glist asked me if the broadcast networks were in the same business as the cable networks referring to the difference between this and this. And I said no, they aren't.

And of course, what I meant by that is, at this time, broadcast networks are not in that business because they're not seeking subscriber support. The whole point of this proceeding is to find out what their price would be if they were partly subscriber supported. That is, if they were in the same business as these basic networks -- rely both on advertising and subscriber revenue.

In order for the networks to be in that business, at least fully in that business, then they would have to get subscriber revenue as well; and that's what the analysis is all about.

MR. OSSOLA: I have nothing further.

CHAIRMAN GRIFFITH: Any recross, Mr. Glist?

RECROSS EXAMINATION

MR. GLIST: When Mr. Ossola just asked you about network compensation, I just wanted to make sure that we're on the same page here. For the commercial broadcasters today -- I'm not as good as some of the other artists.

MR. OSSOLA: We do have an it extended, Paul.

MR. GLIST: I rather like this. I'm from Texas, so we'll just make Texas --

(Laughter.)

BY MR. GLIST:

Q A network might have a broadcast affiliate in Dallas, right, which has an over the air reach like that. I know I've exaggerated Texas, but it's in my nature as a Texan.

(Laughter.)

A Somewhat smaller than four states.

Q Yeah.

(Laughter.)

And it would have a terrestrial affiliate in Houston. There might be interstices between the off-air reach of these terrestrial affiliates, is that right?

A In some cases.

Q In some cases?

A It's not a matter of -- these aren't sharp delineations.

Q They're not sharp --

A The signals are fuzzy and they just get continually --

Q But the commercial networks make it their business to affiliate with terrestrial broadcasters in order to try to cover as much of the country as humanly possible?

A Yes.

Q And so if a commercial broadcaster looks at these, the existing arrangements, and virtually every market in the country is for net net, money flows from the network to the terrestrial affiliate, is that right?

A Yes.

Q Okay, suppose he determines that there is an area here that cannot receive a signal off the air from Houston or Dallas, one of his options would be to establish an affiliate relationship with a broadcaster in this part of Texas, right?

A I suppose so.

Q And in a case like that, they would enter into an affiliation agreement and presumably network comp. would flow here.

But there might be interstices in which -- that was a yes, your nod?

A Well, I'm going to accept the assumption for purposes of wherever you're going.

Q Oh, okay; then let's take the next step.

Suppose that a commercial broadcaster determined that it is simply not efficient to establish towers in every holler in which an over the air affiliate cannot deliver a signal, and there is a satellite in the sky that can reach those interstices, --

A These are white areas you're talking

about.

Q These are white areas that we're talking about.

Now, in a free market, absent a compulsory license, couldn't that broadcaster conclude that the efficient thing for me to do is affiliate with this satellite and have this satellite act as my affiliate for delivering viewers to my national audience that I'm selling to advertisers?

A Sure. But you have to remember that market prices are set both by demand and supply. And the demand side of this market is one in which the entity that's buying these rights is thereby able to generate very large revenues unlike an affiliate from subscribers.

And so the demand for the signal generates a price which is completely out of proportion to what it would be if there were no such revenue source.

Q And okay, well let's do this. You're talking about the willingness to pay here, or what?

A Well, that's one way to think about demand is willingness to pay.

Q And is that -- that's where the Knoll study comes in that you cited in testimony?

A I don't think we're talking about the same thing.

Q You're not focusing on the ultimate viewer sitting in the home; you're looking only at the satellite company?

A I'm thinking about the satellite company's demand for this programming which it would in a free market have to compete for with other satellite carriers; and that, of course, is derived from the willingness to pay individual viewers.

Q But from the point of view of the seller, of the network, --

A Yes.

Q -- he is driven to try to bring these white area customers into his population to whom advertising is --

A Of the things he could, that would produce higher advertising revenues.

Q You also testified just a moment ago that the impact of an increase to $1.22 would have -- would be too small to have an effect. Is that what --

A In my opinion, it was not large enough to affect the number of satellites or the number of channels on those satellites.

Q Do you know what the impact of a three cent reduction in the royalty would be on network investment and programming?

A We're talking about this same royalty rate?

Q Yes.

A I don't know the magnitude of it, but it will be very small.

Q Very small. Too small to have an effect?

A Too small to have much of an effect anyway.

Q You also testified about an elasticity study being irrelevant, and I'm trying to understand that.

Doesn't an elasticity study measure whether customers are likely to pay an increased price rather than drop the service?

A An elasticity study measures the extent to which subscribers would drop the service in response to a given increase in price.

Q Right. And so your testimony about what's likely to happen has been given without benefit of any elasticity study?

A No, I think you misunderstand what I'm saying.

What I'm saying is that I'm making the two extreme assumptions that could come out of such a study which is either the elasticity is infinite or it's zero. Okay, and in either case, the result is that there is not a significant impact. So it doesn't really matter to me whether it's .5 or .56 or some other number in between there.

Q You're just willing to assume that however bad it could be, it would not be significant?

A The worst case is that it's not passed on at all, the reason for which we -- that is a very elasticity plan on the part of subscribers, right, because that's the only reason that you wouldn't want to pass it along.

And then we're talking about at worst, $56 million dollars spread over the entire industry.

Q But why isn't the worst case flowing that through to customers and having the prices increase?

A Because if the effect of that were to reduce customers significantly, it wouldn't be passed through.

Q You have followed the cable television industry in your career, I believe?

A Yes.

Q When cable television rates increase, isn't there a response among customers and politicians, for that matter?

A Well, it makes a difference. It's certainly a response of politicians.

Q Well, let's take that first.

The recent cable rate increases that have been announced this year has provoked a political response, has it not?

A Yes.

Q Senator McCain has threatened to hold hearings in April on that?

A I don't know about that.

Q You don't know about that.

What is the political response that you had in mind?

A I saw press reports of politicians saying that it was unfortunate that prices were going to go up.

Q And how about last year when TCI increased cable rates; didn't the financial press report that they lost 70,000 customers?

A I don't know what they lost.

If they lost 70,000 customers, my guess is they lost from the satellite, not to the rate increase.

Q But you don't know?

A No, I don't.

Q Okay, and on home shopping, you're saying home shopping channels are not in this box -- they're not basic cable nets?

A They are not in the same business, that's right; they're not comparable.

Q They're not comparable. Because these are dual revenue stream services?

A Yes.

Q They are financed by selling advertising and by collecting license fees from the limited number of customers to whom they are transmitted?

A Yes.

Q And then over here, we have premium services which have no advertising.

A Right.

Q And they are financed exclusively by license fees?

A Yes.

Q And over here, we have commercial television network broadcasts which are financed entirely by advertising revenue?

A Well, that's the most fundamental point I've been trying to make all day. We do not have that. This is about what the fee would be if broadcast networks were supported both by advertising and by subscriber support from cable -- satellite carriers.

Q I'm asking you about today. The commercial television networks today are financed and their program purchases are sustained through the sale of advertising, isn't that correct?

A Today we're down here. That's not what this proceeding is about.

Q No, you're not down there. You're at nine billion, aren't you?

A Yes, this is where this is. This is where I'm pointing. Times three, it's nine billion or whatever.

Q So okay, today the broadcasters are not in this box.

A That's right.

Q And services are not in this box, right? These are different businesses, aren't they?

A Today they are. Right, that's why we have to estimate what the rate would be if they were in the same business, which they would be if they were allowed to sell in a free market to the satellite carriers.

Q And it is that projection from one business to another that gets you to the $1.22 plus or minus 55?

A I'm not sure I used those exact words, but that's the essence of it.

MR. GLIST: I have no further questions.

CHAIRMAN GRIFFITH: All right.

MR. GARRETT: I have recross.

CHAIRMAN GRIFFITH: All right, Mr. Garrett.

RECROSS EXAMINATION

MR. GARRETT: Dr. Owen, I'm Bob Garrett. I represent the Joint Sports Claimants in this proceeding.

If I can just go to Mr. Glist's map here -- where's Washington on this map?

(Laughter.)

MR. GLIST: It's way over the horizon.

MR. GARRETT: Just past Texas?

BY MR. GARRETT:

Q All right, let's take -- you're familiar with station WJLA TV here in Washington, D.C., Dr. Owen?

A If you'll tell me what number it is, I will.

Q Channel 7.

A Yes.

Q That's an ABC affiliate in Washington, D.C.?

A Right.

Q And WJLA broadcasts programming from the ABC network?

A Yes.

Q When WJLA broadcasts programming from the ABC network, it doesn't charge viewers anything to receive that programming, does it?

A No.

Q And ABC doesn't charge the viewers in the Washington, D.C. area anything to receive the signal of WJLA?

A No.

Q Now we've got up here -- is this a satellite up here? Now it's a satellite.

WJLA is placed on satellite by friends of the satellite carriers, is it not?

A Right.

Q And when WJLA is sent down around the

United States, a charge is imposed by the satellite carrier in order to receive WJLA, correct?

A Yes, they charge the subscribers for you.

Q Okay. And they don't -- unlike WJLA here, satellite carriers aren't providing that ABC programming for free to anyone, are they?

A No, they're not.

Q All right, they're imposing a fee upon consumers across the United States in order to receive the WJLA signal including all of the ABC programming, correct?

A Yes.

Q All right, and the purpose of this proceeding is to determine what the fair share of that fee is that should go to copyright owners, correct?

A Well, I think in the first instance, it's to decide what the fee should be, and then what the fair share is.

Q Well, I'm sorry; the fee I was referring to is the fee that they impose upon the consumers across the United States in order to receive WJLA.

A Right.

Q They impose those charges upon consumers and then what we determine here is what portion of those charges should be shared with copyright owners, correct?

A Or the charges as they would be after an appropriate wholesale price was set, yes.

Q Okay. And what you've done in your study here is to give us your best estimate of what you think the fair share is for copyright owners of network programming, correct?

A I've tried to give you my best estimate of the price in the aggregate that would be paid for the programming; therefore, to all copyright owners, yes.

Q Okay.

MR. GARRETT: I have no further questions. Thank you.

CHAIRMAN GRIFFITH: All right.

Anything further?

MR. OSSOLA: I have redirect.

CHAIRMAN GRIFFITH: All right.

REDIRECT EXAMINATION

BY MR. OSSOLA:

Q Dr. Owen, you -- do you recall making a statement that additional white area viewers would, all things equal, increase the networks' advertising revenues?

Do you recall that, making that statement in response to a question from Mr. Glist?

A Yes.

Q Do you know whether things in fact would be equal in that setting?

A They never are.

Q From the standpoint of advertisers, are they likely to view the rural subscribers the same way as they view other subscribers?

MR. GLIST: Leading; objection.

CHAIRMAN GRIFFITH: Objection sustained. It is leading.

Do you want to rephrase it?

MR. OSSOLA: Yes.

BY MR. OSSOLA:

Q Do you know how advertisers may view rural subscribers versus urban subscribers?

A I have an understanding of how advertisers decide how much different viewers are worth.

It's based not so much on rural versus urban as upon demographics. How much income they have to spend is an important consideration. Their age and their sex determines what kinds of things they would buy if they had money to buy it.

There may be a systematic relationship between rural and urban and those things. I mean, one has a picture of rural viewers are being less affluent, and I don't know whether that's true or not.

Q If I may, let me go back to the -- Mr. Glist's irresistible sketch.

And he was positing, I believe, a situation in which the networks would have coverage throughout the United States represented by the circles, is that right?

A Right.

Q And that at least with respect to the network signals, the satellite carriers would be reaching -- I think Mr. Glist used the term interstices.

A Which I understood to mean white areas.

Q Correct.

Now what is your understanding as to the scope of the satellite carriers' business with respect to the network signals and the white areas?

That is -- let me rephrase it.

What is your understanding as to what the satellite carriers are entitled to do with respect to the network signals?

A Oh, my understanding is they're only entitled to sell them to make subscribers in the white areas, not anywhere else.

Q In terms of Mr. Glist's chart, that would be in the interstices between coverage areas?

A The only way there's no broadcast signal, or however it's defined, for a cable company.

Q Would the networks have -- or what would the scope of the networks' coverage be with respect to the rest of the United States looking at them --

A The satellite's will not be covered in the rest of the United States.

Q How about from the standpoint of the networks and their broadcast signals?

A They would be reaching the rest of the United States through their affiliates.

Q Given that, what would you say about the respective bargaining position between the networks and the satellite carriers in a free market value transaction negotiating over the price to be paid for sending that network signal into these interstices?

A Well, as I tried to explain before, I think the fact that there's actual dollar revenues from subscribers, it's far more important than the advertising revenue, whatever it is. Even if those viewers are worth a lot to advertisers, in those terms, we're talking a few cents -- few cents per month.

Whereas the subscribers, whatever it is exactly that they're willing to pay, is measured in dollars per month. So the bargaining power is on the part of the networks.

Q Thank you.

MR. OSSOLA: I have nothing further.

CHAIRMAN GRIFFITH: All right.

MR. GLIST: One more.

RECROSS EXAMINATION

BY MR. GLIST:

Q Dr. Owen, did you say that advertisers spend only a few cents per household?

A It's a few cents per households.

Q Don't television advertisers spend over $300 per TV household?

A Per year?

Q For whatever period you're mentioning.

A Not per month.

Q Per year?

A It's possible, yeah.

MR. GLIST: No further questions.

CHAIRMAN GRIFFITH: All right.

Dr. Owen, thank you very, very much, sir. You may step down. You're free to go.

THE WITNESS: Thank you.

(The witness was excused.)

CHAIRMAN GRIFFITH: All right.

Ladies and gentlemen, I presume that concludes our testimony and evidence to be taken today. And we're going to hear from Gerbrandt --

MR. GARRETT: Mr. Gerbrandt tomorrow.

CHAIRMAN GRIFFITH: Gerbrandt tomorrow morning at 10:00?

MR. GARRETT: That's fine with us, Your Honor.

CHAIRMAN GRIFFITH: All right, we'll adjourn at this time until 10:00 tomorrow morning.

(Whereupon, the proceedings were adjourned at 2:38 p.m.)

CERTIFICATE

This is to certify that the foregoing transcript in the matter of: Hearing: Satellite Rate Adjustment, Docket No. 96-3 CARP-SRA

Before: Library of Congress
Copyright Arbitration Royalty Panel

Date: March 24, 1997

Place: Washington, DC

represents the full and complete proceedings of the aforementioned matter, as reported and reduced to typewriting.

Copyright Arbitration
Royalty Panel

Satellite Rate Adjustment

03-24-97

p1797-1973

WP5.1

Neal R. Gross & Co.
(202) 234-4433